Zaidi

ISSUES IN PAKISTAN'S ECONOMY

THIRD EDITION

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A POLITICAL ECONOMY PERSPECTIVE

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Preface to the first edition

Writing this book has been a challenging and often daunting task. The idea originated from the staff of Oxford University Press, who suggested that there was a need for a book on Pakistan's economy, which could be understood by graduate students, researchers, scholars, academicians, and the general public at large, even without having a sound grounding in economic theory. This has indeed been the focus of the book, targeting a wide spectrum of readers, in simple language, exploring processes, ideas, and trends. I hope that this book will provide new insight on numerous home truths and myths which abound in Pakistan, and allow the reader to question what is perceived to be conventional wisdom. The most ambitious of the many aspirations of this book is to stimulate the process of enquiry amongst readers. I do not expect all readers to agree with me, but I hope they will see and welcome the different interpretation that is presented here. This, I hope, will generate debate, which is, after all, the purpose of enquiry. Since there are no absolutes in social science, only interpretations and perspectives, let this book be a new, and one hopes fresh, perspective on the economy and society in Pakistan.

This project started when I was an Associate Professor/ Senior Research Economist at the Applied Economics Research Centre, University of Karachi, where I worked for almost fifteen years and taught a course called 'Issues in Pakistan's Economy'. All my professional life was spent at the University, and I owe a debt of gratitude to the institution, and my former colleagues and students, for shaping my way of thinking. I was forced to leave the Applied Economics Research Centre under rather sad and unfortunate circumstances. My departure was only partially voluntary, and was largely in disgust at the goings on at the University and the Centre at that time. However, the work on this book continued at home, and the end result of this endeavour, which has taken four and a half years, shows that research and scholarly pursuit are possible by 'independent' researchers not necessarily affiliated to any particular organization or institution.

Despite this 'independence', however, one cannot pursue intellectual and academic interests without interaction and exchange of ideas with other scholars and academics. A number of friends have been a constant source of pleasure and irritation, in the extended discussions that I have had with them over the years. Aly Ercelawn, Asad Sayeed, Anjum Altaf, Arif Hasan, Jaffer Ahmed, Rathin Roy, Talat Aslam, and Shahzad Amjad have all spent hours and days over the last few years, arguing with me over what I thought were important issues. We remain friends despite our severe disagreements. I often refused to accept their opinions, thinking that I was the one who was always right. However, I am now more willing to accept my numerous faults, shortcomings, and mistakes and to give credit where it is due. To all these friends named above, who have inspired me at different times for different reasons, I give my heartfelt thanks for bearing with someone who has the reputation of being a difficult and stubborn person, prone to long bouts of brooding. Arif Hasan, in particular, deserves immense gratitude for taking the effort to read through the entire raw manuscript and for his generous encouragement.

I acknowledge the persistence of the Oxford University Press staff at Karachi, in making me accept and start this project. In particular, Yasmin Qureshi and Nighat Gaya were instrumental in my taking on this assignment. Zohrain Zafar, who later managed this project from OUP Karachi, is also acknowledged for directing my overly ambitious enthusiasm into concentrating on the task at hand. It is due to Zohrain that I completed this project on time. Although this has been an enormous undertaking, one which I may not have willingly accepted on my own, I now feel the wiser for having undertaken it.

After I submitted this manuscript to OUP Pakistan in August 1997, it was sent on to OUP in Oxford for the final production phase. Moreover, while the manuscript was being managed and edited at Oxford, I too was at the University of Oxford as a Visiting Scholar on the South Asian Visiting Scholars Programme. My presence in Oxford at a critical stage of the editing and management of the manuscript allowed me to interact closely and frequently with the editor of the manuscript and with the Oxford University Press staff handling the book. I must acknowledge the great help and understanding offered to me by Sally Rigg and Tony Dale of the International Education Unit at Oxford University Press in Oxford. The editor of the manuscript, Chris Bessant, has quite remarkably transformed the manuscript into a book; to Chris I acknowledge a huge debt for such a highly impressive achievement. I must also mention Aditya Nigam and Anandhi, two other scholars with me on the South Asian Visiting Scholars Programme at the University of Oxford, for making me reconsider numerous biases which I held under the guise of convictions. Had I met Aditya and Anandhi a few years earlier, this book would probably have taken on a different form.

The special contribution made by Qaisar Anjum and by Mukaram Farooqi, in typing and producing the manuscript, is beyond praise. They have produced work of exceptional quality, under unrelenting pressure from me to meet a constantly shifting deadline. To them, my wholehearted and sincere thanks.

Although it is customary to thank one's family for their inspiration and silent contribution, in my case things are a little more complicated. Both my sons Faiz and Amar still wonder why their father does not go to work: I hope when they are in a position to read this book, they will understand that one can 'go to work' sitting in the next room. Rabab, too, has often felt that I spend too much time doing academic work and not making lots of money; to her, thanks are due for being patient, supportive, and understanding, and for not complaining too much.

S. Akbar Zaidi
Karachi, August 1998

Preface to the second edition

The feedback from students, teachers, and researchers, on the first edition of *Issues in Pakistan's Economy*, published in 1999, is that it has done remarkably well. Very soon after it was first published, it became the standard text for students and researchers on Pakistan's economy, both in Pakistan and at universities abroad. The book is being used for courses on South Asia's development, economic history, and on its political economy at the universities of London, Cambridge, and Oxford and at universities in the US. In Pakistan, *Issues* has become the main text for students studying the country's economy at a postgraduate level in numerous colleges and universities, and has, in fact, even had specific courses designed around it. For researchers on Pakistan's economy, this book has become their main text for reference.

I have been a little surprised by how well the book has done. Part of the reason for its success has been, not because of *Issues* per se, but due to the lack of other quality publications on Pakistan's economy. It is rather sad and disappointing, that even after so many generations of social scientists—particularly economists—having made their mark as researchers and teachers, there are very few good academic books available in the market, and even fewer books that are meant for serious students. In an era when economists are now exclusively consultants, or work for the private and NGO sectors, scholars and academics no longer have the desire (or need) to publish. *Issues* has done well because there are so few books available.

This second edition is a considerably expanded, updated, and revised version of the earlier text. It contains a large amount of new material, all tables and data have been updated to the most recent available, and new chapters and themes have been added on. While the second edition of *Issues in Pakistan's Economy* is written and presented in much the manner as the first, in a political economy context and framework—with boxes, appendices, summaries of chapters, and suggested further readings—contemporary, new, and emerging issues have now also been discussed and analysed. Along with substantial revision, significantly, three new chapters have been written and added on to this second edition. Chapters on Poverty in Pakistan—one of Pakistan's most pressing problems—on the political economy of economic and trade relations between India and Pakistan, and on macroeconomic developments since 1998, are the three new additions. Along with this, there are substantial new additions on Globalization, WTO, Pakistan's new Local Government system—that of District Governments—and particularly on a re-evaluation of the Political Economy of the Pakistani State. In fact, Chapter 22 on 'Class, State, Power and Transition' (which was Chapter 19 in the first edition) has been completely reformulated.

Since 1997, I have lived a life largely of voluntary unemployment, which at times turns into self-employment whenever work comes my way. I have chosen to continue writing, doing research, lecturing at universities in Pakistan and abroad, and publishing books and journal articles working from home. I have survived financially, although at some cost, by doing the few consulting assignments that have come my way. Rather than become a full-time 'consultant', the new trend amongst economists and social scientists, I have preferred to continue with my academic and research interests. It has not been an easy existence, but I feel that I have accomplished a huge amount in terms of research, output, and publications, and have received considerable recognition for my work. Given the demise of the academe and the absence of a community of scholars in Pakistan, the feedback that one receives for such pursuits, at times, compensates for the rather lonely intellectual life of a self-motivated independent social scientist.

A number of friends and other readers deserve thanks for encouraging me to continue my research and for their responses to *Issues* when it was first published. Arif Hasan, singularly, deserves thanks for his friendship, encouragement, wisdom, and enthusiasm for what I do. Professor Mahmud Hasan Khan has been another source of inspiration and learning, and to him, my thanks too. Sadiqa Salahuddin was a great enthusiast when *Issues* was first published in 1999, and publicized the book endlessly; Amama Shabbir who taught at Hamdard University and at the IBA in Karachi also deserves thanks for using the book and for propagating it amongst students of business studies. Riaz Riazuddin of the State Bank of Pakistan, asked me to add some new ideas, which have been incorporated. My thanks also go out to Zahir Riaz, an old school friend and now an eminent lawyer, simply because he bought the book, something that suggested to me, that perhaps there is an audience out there for whom one should continue to write.

I no longer remember why I wrote *Issues in Pakistan's Economy*, except that it was Nighat Gaya then at OUP Karachi, who called me up one day in 1994, and said that a book on these lines was needed; I ended up giving four-and-a-half years of my life to writing the book. Yasmin Qureshi and Zohrain Zafar then marshalled me to its completion. Although I was told by many readers that the book required a new version—expanded, revised, updated—something that I realised very well, for many reasons, I was reluctant to start work on it again. However, OUP's Samuel Ray, in his reassuring and soothing tone, twisted my arm into doing so, something for which I am now very grateful. I believe that the one year that I have spent revising and expanding *Issues*, has made the second edition even better than the first.

S. Akbar Zaidi
Karachi, 6 January 2005

Preface to the third edition

In critical ways this, the Third Edition of *Issues in Pakistan's Economy*, is a very different book from the first two published in 1999 and 2005. Rather than merely revise and expand the Second Edition, the Third Edition undertakes a considerable rethinking and refocusing of issues which constitute Pakistan's economy. Importantly, as the new title also suggests, the focus this time around, has shifted to a *far sharper political economy perspective*. Since my training and interest is mainly in political economy rather than just mainstream economics, both the First and Second Editions were also heavily influenced by this perspective. Nevertheless, while both the earlier Editions focused more on economic history in telling Pakistan's story of economic development and structural transformation, this Third Edition builds on the earlier Editions but concentrates far more on political economy. This is particularly so, since while much of the story of Pakistan's economy has been more of the same for some decades now, with all governments following neo-liberal economic policies and regardless of supposedly differing 'ideology', all continuing to depend on the IMF and other donors to bail them out, it is clear that issues central to Pakistan's political economy—such as class, power, the state, transition—have all undergone considerable change since the publication of the Second Edition in 2005. Hence this noticeable shift and reworking of issues in Pakistan's economy, with a far greater political economy perspective.

As I wrote in the Preface to the Second Edition, I continue to be surprised by how well this book has done and that it has become the standard text for students and researchers on Pakistan's economy, both in Pakistan and at universities abroad. The book is being used for courses on South Asia's development, economic history and on its political economy, at the universities of London, Cambridge and Oxford and at numerous universities in the US. In Pakistan, *Issues* has become the main text for students studying the country's economy at a postgraduate level in numerous colleges and universities, and has, in fact, even had specific courses designed around it. For researchers on Pakistan's economy, this book has become their main text for reference.

Part of the reason for this success has been, not because of *Issues* per se, but due to the lack of other quality publications on Pakistan's economy. It is rather sad and disappointing, that even after so many generations of social scientists—particularly economists—having made their mark as researchers and teachers, there are (still) very few good academic books available in the market, and even fewer books which are meant for serious students. In an era, when economists are now exclusively consultants, or work for the private and NGO sectors, scholars and academics no longer have the desire (or need) to publish. I still maintain that *Issues* has done well only because there are so few books available.

Apart from the sharper focus on political economy and a considerable rewriting and updating of many of the earlier chapters, the Third Edition also includes many new chapters and sections within chapters, adding more than three hundred pages to the Second Edition. Six new chapters have been added, on: Local Government and Decentralization; the new Fiscal Federalism and Eighteenth Amendment; Regional and Income Inequalities; the relationship between Health and Poverty; a chapter on the economics and political economy of the War on Terror and aid to Pakistan; and, a fresh examination of Pakistan's changed Political Economy. This book builds upon all my research and publications since the Second Edition in 2005, and I have made use of many of my published articles in the Third Edition.

The structure of the book remains largely the same as the previous Editions, with boxes, appendices, summaries of chapters, and suggested further reading. The book also continues with its focus on an attempt to analyse and understand and explain *what is*, rather than suggest *what ought to be*. It offers no advice or solutions on how to fix things and concentrates more on how the economy and social and material relations of production and exchange actually work in Pakistan. The book highlights problems, issues and constraints in a political economy framework, and stays away from the lucrative though unproductive industry of offering advice. Much technocratic advice fails precisely because it is not located within a political economy context, where issues of power and control are central.

I would like to thank some individuals who have helped in completing this Third Edition. Asim Bashir Khan, in particular, deserves many thanks for his extensive support in updating the data in *Issues*, and also for contributing Chapter 13 on Fiscal Federalism. I am very grateful to Asim for all the time he gave and hope he will build upon his multiple analytical abilities and skills and join the economics profession. Aly Ercelawn, one of Pakistan's few radical economists for whom issues of social class and equality are central, contributed Section 23.4 on Income Inequalities. Ercelawn suggested to me that I ought to include a section on inequalities and immediately volunteered to contribute the Section when asked. Samuel Ray of OUP deserves thanks, as always, for seeing this project through so professionally.

Academic research is always a collaborative project and sometimes through active discourse with scholars and friends, one learns a great deal; sometimes that learning and understanding takes place through what one reads of the work of writers and scholars whom one never meets. As the text and references of *Issues* clearly reveal, I owe many debts to such scholars, most of whose work I have learnt from and continue to hold in high regard. The Bibliography and other citations in each of the chapters indicate all such influences. There are many disappointments with numerous scholars as well, many of whom wrote seminal dissertations or made some exceptional contribution some years ago, but then opted to become consultants, not having produced any

work in the public domain or worth citing since. One feels a sense of collective intellectual loss which also helps explain the reasons for the dismal state of the social sciences in Pakistan. Nevertheless, I have more hope and expectation from a growing set of younger academics who proceed for, or have just completed, their doctoral dissertations. This younger generation of social scientists, one hopes, will add their contribution to many of the debates which take place regarding social change and transformation in Pakistan, as did an older generation three decades ago.

S. Akbar Zaidi
Karachi,
30 April 2014

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Introduction

Pakistan's economic performance since 1947 has been, at times, quite spectacular, and at others, nothing but dismal. It failed to maintain the high growth in agriculture and manufacturing which it experienced in the 1960s, after a difficult start in the first decade following independence. The 1970s, for a host of reasons, most beyond the control of the incumbent government, were not even a patch on the 1960s, although surprisingly in the 1970s the economy performed better than it did in the 1950s. Towards the end of the 1970s, and for much of the 1980s, until at least 1988, the high-growth pattern re-emerged, although qualitatively different from the growth performance of the 1960s. The economy in the 1980s seemed to be on a higher plane than that of the 1960s. There were murmurs that perhaps Pakistan had once again returned to the 'natural' growth rate path of 6 per cent plus, and would now continue where it had left off in 1968–9. However, just as the ten-year period after 1958 had unravelled, resulting in an appreciable slowing down of the economy, so too did the end of the ten or so years from about 1978–9 onwards.

With the praetorian electoral charade starting in 1988, the growth rates of the economy once again fell to levels reminiscent of the first democratic period of 1971–7. This trend gave rise to suggestions that, since growth rates in Pakistan were highest under military regimes, and under democracy the economy had performed particularly poorly, perhaps one way of achieving high growth rates for the economy would be to maintain military regimes. The often-quoted examples of South Korea, Taiwan, Singapore, Malaysia, Thailand, and Indonesia seemed to fit the pattern, where authoritarian states had high-performing economies. This pattern was repeated again and the claims made in Pakistan, when the military-led government resulted in 7 per cent growth rates between 2002–7, and when the democratically elected government between 2008–13, could manage only 3 per cent growth.

Yet much of the analysis that examined the economic miracle of East Asia and other countries, ignored specific factors, institutional arrangements, the nature of the state, and issues of governance and administration. There are as many differences between the East Asian economies as there are similarities, and a more detailed study of each country shows peculiarities which explain why and how they developed. In fact, Pakistan's growth pattern, at least in the 1960s, also offered some general and particular pointers on how to 'do development'.

The period after 1988 brought about an extraordinary sea change in how the world thinks about economics, markets, growth, and development. In the 1960s the single focus was growth, with little concern for distribution, equality, or any other consequence of growth. Growth was supposed to trickle down from the high-income and rich savers and investors to the rest of the population. Now in the 21st century, growth is still important, but is subservient to a development which needs to be participatory, distributive, just, sustainable, and environmentally friendly. A growth rate of 7 or 8 per cent, while welcome, must be seen in the light of these other important indicators of development.

More important, the way growth is to take place now differs substantially from the way economic growth was supposed to take place prior to the mid-1980s. Markets must be efficient and must determine the demand and supply of scarce resources. States and governments must stay out of the economy, and privatization, openness, liberalization, and globalization, according to conventional wisdom, must determine choices regarding how and where to invest and what to produce. Countries should get their prices right, and reduce subsidies and all other distortions in the economy. Even in the social sectors, the role of the state is supposed to be minimized, with private sector initiative leading the way.

One of the arguments made in this book is that since 1988, when a package of neo-liberal policy reforms was introduced, the economy has performed less well than it had in the past. To a great extent, the Structural Adjustment Programme, launched in Pakistan in 1988 under the guidance and direction of the International Monetary Fund (IMF) and the World Bank, resulted in a visible slowing down in the economy, increasing income inequality, poverty, and unemployment, and hastening the process of deindustrialization. Moreover, Pakistan's wider political economy, and the failure of its elite, has made it dependent on multilateral and bilateral aid.

Ironically, although the example of South Korea in particular, and that of other East Asian economies in general, is repeatedly cited for Pakistan to emulate, the conditions and policies that were essential for the growth of the East Asian economies *were quite the opposite* of those that were propagated post-1988 under the Structural Adjustment Programme. As an illustration, we can cite just a handful of policies pursued by South Korea which are believed to be the critical cause of high growth.

South Korea's was certainly what is called an 'authoritarian industrialization pattern', where the existence of a developmentalist bureaucracy and state, and an *interventionist* bureaucracy and state, were fundamental to the process of growth that emerged. In Korea, landlordism was abolished and an extensive land reform undertaken. Cheap credit,

i.e. directed credit, was made available to the private sector at subsidized rates, with certain sectors receiving priority treatment. Prices were continuously projected as 'wrong' rather than right, with numerous government-imposed controls and restrictions pushing the industrial pattern in a preferred direction. Essentially, it was the state, a particular kind of state, that intervened in the process of economic development, *and not simply the market*, which was responsible for the extraordinary rate of growth observed in South Korea and much of East Asia. In contrast, just the opposite to interventionist and statist policies were recommended for Pakistan in the post-1988 structural adjustment period with privatization and market-based policies being advocated as the state withdrew. One can make the case now, that in Pakistan, private sector-led development will be more vulnerable to the market than state-led economic development, resulting in more variable and unsteady outcomes. There is still much merit in the role of the state as developments after the global crisis of 2008 have re-emphasized.

While a comparison of the Ayub, Zia, and Musharraf years shows that the decades of the military generals achieved high growth, it also suggests that at the end of the respective decades, the growth performance unravelled because the existing political settlement that permitted high growth came into conflict and contradiction with the very structures and systems that it had created. The result was the emergence of popular movements and opposition to the military regimes, and the foundation of a kind of democratic order. The legacies of Zia thirty years later, and of Musharraf five years after his dismissal, suggest that bad decisions can have permanent debilitating consequences.

This book, after developing a factual and interpretive story about structural transformation and economic growth and development of Pakistan since 1947, ends with the observation that a new economic and political order has emerged in the country. For want of descriptive terms, this new order is called the 'middle-class consolidation', after 1988. The reasons for it are to be found in the twenty-seven chapters of this book. We argue that, while as an economic category the middle class emerged and consolidated itself, first in the late 1960s, and then again in the 1980s, it has only now begun to consolidate itself as a political entity and force. Having said this, it is important to emphasize that nowhere do we glorify this class, if indeed it is *one* social class, for this is no pristine, revolutionary, and progressive class. This is Pakistan, and Pakistan's corrupted, rent-seeking, inefficient, and pampered middle class which is socially conservative and fragmented, contradictory in nature and in its working, includes both highly traditional religious and conservative sections within this social category, as well as indigenous and modern groups. It does not see the essential prerequisites of human capital formation and infrastructure development, for progress, for itself, or for the nation in the years to come. Pakistan's middle class, like all other classes present, has evolved in the particular and specific conditions that define what Pakistan is. To expect otherwise, that we would necessarily have a modern, progressive, educated, forward-looking middle class, as did Europe some centuries ago, or Latin America some decades ago, is wishful thinking.

The explanations of how state and society have evolved in Pakistan also emphasize the fractured nature of both, with infomalization perhaps being a key category of analysis.

About the Book

There is no denying the fact that this book has an ambitious agenda. We question some of the most repeated, incorrect statements perpetuated by students of Pakistan's economy and society. While this is perhaps a key purpose of this book, we also provide new facts about, and interpretation of, areas of the economy and time periods that have not been evaluated by researchers or academicians. Hence, the purpose is two-fold: (1) to re-examine much of the perceived conventional wisdom about developments in Pakistan's society and economy, myths which have now assumed the scale of folklore; and (2) to provide facts, data, and information about the economy, particular sectors and recent years, which are not to be found in other books on the topic. Here an attempt is made to look at historical events and developments of the past, as well as more contemporary issues. This book is meant to explain Pakistan's structural transformation over six decades in a political economy framework and explore how that change has taken place.

In the first chapter, we try to assess whether Pakistan's six decades of development and growth along with its significant structural transformation, has been a success or failure. However, this is an impossible task, and in many ways, the issue itself is redundant. The parameters of success or failure, the comparisons over space and time, the possibilities of what might have been, etc. are so imponderable and complex that it is best to leave such debate inconclusive. Pakistan has performed far better than, say, Afghanistan; however, it has fared far worse than South Korea or any of the East Asian economies, which were at comparable levels of development forty or fifty years ago. And now, with most South Asian countries, especially India, Sri Lanka, and even Bangladesh, overtaking Pakistan in terms of economic and human development, perhaps one can suggest that Pakistan has been left behind and is increasingly looking like a failed state. While we look at many of Pakistan's achievements and failures since 1947, we leave it to readers to reach their own conclusions based on the arguments presented in this chapter and the rest of the book.

The most popular myth still prevalent in Pakistan is that Pakistan is a feudal country. In Part I of this book, which deals with agriculture, and especially in Chapters 2, 3, and 4, we show that this is certainly not the case—feudalism, as the dominant economic category, may have passed into history many decades ago. What we see now, and have seen for many years, is a capitalist agriculture in Pakistan. Another often-quoted statement by students studying Pakistan's economy—through no fault of their own, for one finds these statements in most textbooks on economics—is that Pakistan is an agricultural country. Although 45 per cent of those gainfully employed are said to work in agriculture, people are moving away from rural areas altogether, or are finding non-agricultural, non-farm, rural employment. The four chapters

in Part I examine the nature of transition in Pakistan's agriculture over many decades, with Chapter 5 examining the salient problems that afflict agriculture at present. The current crisis in agriculture also, perhaps, bears witness to our claim that Pakistan is no longer an agricultural country, or at least, is moving away from agriculture.

In Part II, on industry and trade, the four chapters look at the process of industrialization in Pakistan since 1947. Chapter 6 looks at the period 1947–77, evaluating and rejecting two important assumptions made by observers in the past. The first concerns the performance of the economy in Ayub Khan's Decade of Development. Unlike other interpretations, where the nature of growth has been criticized for being inequitable, we argue that this was an intrinsic and inherent consequence of the capitalist economic policy followed by the Ayub regime. Capitalist economic development manifests its own contradictions and there is little controversy over this form of development. This chapter also takes strong issue with the popular view that the Bhutto regime was a dismal failure on account of the policies it followed. This is found to be factually incorrect. The performance of the economy was understandably not as impressive as the phenomenal growth of the 1960s, but it was better than that of the 1950s. Moreover, it was not all the fault of Bhutto and his economic managers that the economy did not do as well as had been hoped—a multitude of extrinsic and foreign factors that were not in the control of the government affected the economy severely. It seems that political ideology and a dislike for Bhutto have perpetrated the myth of the disastrous 1970s.

Chapter 7 looks at developments in industry after 1977, with particular emphasis on the post-1988 structural adjustment neo-liberal period and its consequences for industry. Chapter 8 analyses the state of industry at present, and the main problems that afflict it, with the energy crisis of the post-2008 period being a particular cause. Chapter 9 examines the development and changing nature of foreign trade in Pakistan, and questions yet another key assertion about Pakistan's economy: that the process of industrialization, under highly protected tariff walls, had been inefficient, and hence gave rise to an industry that was inefficient. However, a large number of studies that examine the impact of trade policy on industrialization have concluded that, while there were problems in the pattern of industrialization in Pakistan, the assertion that it had been inefficient was 'grossly exaggerated'.

In Part III, we analyse fiscal policy, and its impact on and consequences for economic development. In Chapter 10, we examine in detail the nature of the taxation structure and resource mobilization by different tiers of government in Pakistan prior to the changes brought about in 2010, and look at the reasons why expenditure tended to be larger than revenue. Chapter 11 looks at what has been, for many years, considered to be Pakistan's biggest economic problem: that of the large debt burden and the fiscal deficit, considered by many to be the single biggest cause of Pakistan's economic malaise. This latter assumption, however, is contested, and we show that blaming the fiscal deficit for all the economic ills of the country distorts the facts. Rather than being responsible for low growth, high inflation, a high current account deficit, crowding out, and low investment, we find that the fiscal deficit in Pakistan has, until the 1990s, been most benign. Moreover, the fact that government expenditure in Pakistan often crowds out private sector investment is conveniently ignored by mainstream economic evaluations of Pakistan. We find that government expenditure has had quite a positive role to play in development, if this money is spent correctly and in the right areas. What is important when considering government revenue and expenditure is to evaluate who is paying taxes and who is not, how much tax is being collected and how much evasion exists, where and how much government is spending, and the quality of that expenditure. Blanket statements like 'a budget must always be balanced' and 'government expenditure is always wasteful and inefficient' are, in fact, quite erroneous.

Part IV focuses on two key aspects of Pakistan's federalism, that of devolution and fiscal federalism following the 7th National Finance Commission Award and the 18th Amendment in 2009 and 2010. Military governments have always had a preference for devolution—local government without financial authority—and Chapter 12 provides an extensive narrative of the evolution of Pakistan's local government structure since 1959. Devolution, decentralization, and local government seem to be emerging as the new liberal panacea in development theory. We argue that, while they are well meant, such concepts need to be placed in a context of power relations and there are numerous structural constraints, if not prerequisites, which must be addressed to make any of these ideas functional, productive, and successful. Chapter 13 deals with the impact of the seven NFC Awards and what this might mean for development after the 18th Amendment when provinces have far greater autonomy and responsibility.

Part V, Chapters 14 and 15, which look at monetary policy, begin with a history of the banking sector in Pakistan, showing its close imprint on economic development and industrialization. Chapter 14 also looks at the equities market in Pakistan, and after examining the role that capital markets have played in other countries, we argue that directed credit schemes, subsidized credit, and distorted credit markets may be better policy options than fostering and sustaining an equities market that resembles more a game of loaded dice than a mechanism to allocate and ration credit. Chapter 15 on money, savings, and inflation, shows that inflation in Pakistan, and probably elsewhere, is not 'always and everywhere a monetary phenomenon'. Inflation seems to depend more on government-administered prices of key commodities and utilities, and on devaluation, than on an increase in money supply, excessive or otherwise. The reasons for high inflation and low savings in Pakistan also need to be re-examined in the light of the facts rather than on the basis of preconceived notions.

With Part VI we come to the three chapters that describe Pakistan's economic programme since 1988. This is the neo-liberal Structural Adjustment Programme, imposed upon Pakistan by the IMF and World Bank, and so willingly accepted and endorsed by Pakistan's elites. After explaining in Chapter 16 what constitutes the Structural Adjustment Programme and the consequences it has for the countries that have endorsed and implemented it, in Chapter 17

we turn to its impact on Pakistan. The history of IMF and Government of Pakistan relations shows that the two comprehensive programmes of 1988 and 1993–4 were both negotiated and enforced by unelected caretaker governments and had to be ratified by the incoming democratically elected governments—in both cases, interestingly, of Ms Benazir Bhutto. The chapter shows that, since the advent of the programme, the economy's performance has declined rather sharply, causing a significant loss in social welfare, especially for the poorer social classes. We emphasize the point, that in 1988, when the first major Structural Adjustment Programme was implemented, Pakistan *did not really need* such a programme, which is usually reserved for those countries that, according to the IMF, are in deep economic crisis and stagnation. In 1988, Pakistan was actually booming and one of the consequences of following the programme may have been to dampen the high growth performance of the 1980s. We suggest that, although restructuring of the economy is essential, it needs to be done on more friendly terms than those enforced by the IMF and World Bank. The reasons why Pakistan's governments run to the IMF to borrow on any pretext is that they, along with the ruling élite, are not willing to undertake the extensive reforms needed to restructure the economy, for those reforms will hurt the interests of this ruling élite. It is far safer to borrow, delay the inevitable, and pass on the debt burden to the unsuspecting general public. Chapter 18 looks at macroeconomic issues since the mid-1990s, particularly since the General Pervez Musharraf takeover of October 1999 and at the consequences to Pakistan's economy after 9/11. It also evaluates the dismal performance of the PPP government of 2008, acknowledging the claim that numerous deep-seated political and economic issues were beyond the ability of the PPP government to address or reform, yet also holds the government accountable for mismanaging the economy.

Chapters 19–21, which constitute Part VII of the book, try to understand Pakistan's development paradox. With impressive growth in different sectors of the economy, the performance of the social sectors has been visibly poor. The development paradox has a dual meaning here, since not only has economic development not translated into social sector development, but the fact that impressive economic development has taken place *without* an adequate social and human capital base is itself perplexing. Different subsectors in the social sector, such as health, education, housing, and population, are analysed in Chapters 19 and 20. We question the assertion that population, just like the fiscal deficit, is one of Pakistan's major problems, and we find that this is not necessarily the case. Moreover, the population rate seems to be falling now as economic austerity and hardships increase, and it is unaffordable to have large families. There is also a section on gender and women, where we argue that, while cosmetic changes and positive discrimination may address some of the issues facing women in Pakistan, the deep-rooted structures that cause gender bias must be confronted if economic, social, cultural and judicial emancipation of women is to take place. The third chapter in the part on the social sectors, Chapter 21 on institutional issues, looks at institutional factors and constraints that have inhibited social development. Often finances are not the sole problem affecting a sector, but issues of management, administration, and delivery are equally important. Issues like community participation, the role of non-government organizations (NGOs), governance, and decentralization are also evaluated in the light of past experience and current propaganda. We also question the belief that NGOs provide an efficient and productive development paradigm.

In Part VIII, Chapter 22 deals with Pakistan's most pressing issue, that of poverty. Despite high rates of growth, Pakistan continues to have a poverty rate with one-third of its population—60 million individuals—living below a meagre poverty line. With one-third of the country's population living in abject poverty, any assessment of high growth, growing financial reserves and economic 'stability', will need to be re-evaluated. Chapter 23 highlights the issue of regional and income inequality in Pakistan in both a historical and contemporary context.

The last four chapters of the book, in Part IX, look at the impact of the economy on political formations, the state and classes, on war, aid and terror, and on the political economy of neighbourly relations. We argue that much of the evidence presented in this book suggests that Pakistan's middle classes are beginning to assert themselves collectively, not just in economic terms, but also as a political class. While Pakistan has a long way to go to become a modern, dynamic, educated, and vibrant society, we may see the beginning of such developments. In the Political Economics sections of the book, we also examine issues related to South Asia more generally, and trade and economic relations—or their lack of—between India and Pakistan. We show that while there are no real and substantive *economic* arguments which ought to restrict greater cooperation between India and Pakistan, *political* and *institutional* interests override such economic concerns. Trade and economic arrangements are examined in the light of larger political factors. An attempt is also made in the end, to understand how the unravelling of Pakistan's state has occurred. Issues related to state collapse and the relationship between political classes and civil society on the one hand, and the omnipresent military, on the other, form a key part of this evaluation.

Part IX follows the narrative of the evolution of Pakistan's social, economic, and even political dispensations over many decades, highlighting key developments and events. As has happened so many times in Pakistan's history, events with unintended consequences have shaped Pakistan's developments. Yet, social and economic change has also been somewhat anticipated and predictable, giving rise to somewhat more certain outcomes. The immense growth of urbanization, that of a middle class, a hugely buoyant informal sector, and the breakdown of state authority and of state institutions, has been unfolding almost expectantly. The previous trend of the 'urbanization of everybody', seems to have morphed into an 'urbanization with informalization', with the co-movements of urbanization and informal relations of production and exchange perhaps dominating social and political interaction. What this

means for subsequent developments remains uncertain and one can merely (hesitantly) speculate about alternative scenarios.

The aim of this book is to provide, analyse, and interpret something called 'facts'. There is usually, amongst students, a desire for prescriptions and definite answers. This book does not provide them. What the book does, however, is to reinterpret accepted dogma, home truths, and myths about the economy and about society. It is important to emphasize that this is *one of many interpretations*, and readers are invited to contest the claims by challenging preconceived notions.

The emphasis in this book is on *process*. We examine facts and issues and developments over time, placing them in their specific contexts. It is not possible to understand the present without recourse to the past. Pakistan's economy and development today—the word 'development' implies transition and a process—need to be traced back in time; only then can we better understand the present and possibly attempt to look into the future. Nevertheless, the book also acknowledges that such transitions are incomplete, complex, wayward, often built on unintended consequences, and hence one avoids the popular Pakistani pastime of offering advice and making predictions. If one has learnt one thing from Pakistan's recent political history, it is that there is too much that we do not know and there are too many 'unknown unknowns', to hold forth on probabilities. The purpose of this book is not to offer any solutions or prescriptions, but merely help in explaining Pakistan's considerable structural and social transformation.

Data on Pakistan are notoriously poor, of dubious quality, and often fabricated to suit the needs of the government in power. Moreover, as readers will see for themselves, different official sources contradict each other. While most of the data originate from official sources, researchers do manage to get around the numbers. For example, the growth rate of the small-scale manufacturing sector has been reported by government to be a constant 8.4 per cent for more than a decade; as any observer of the Pakistani scene knows, the growth rate has at times been almost twice or even three times this rate.

One of the features of this book is that it relies on, and uses, extensive quotations from numerous published articles and books. This, we feel, will represent the arguments made by the authors themselves, rather than our understanding and interpretation of what the author is actually trying to say. Moreover, one hopes that these quotations and the use of references will whet the appetite of the reader to go to the sources and read their works in the original. Also worth mentioning is the fact that the change in nomenclature of the former North West Frontier Province (NWFP) to the current Khyber Pakhtunkhwa province, has meant that both names are used interchangeably, although an attempt is made to only use Khyber Pakhtunkhwa for references after 2010. Other organizations and institutions have also been dealt with in the same manner.

If this book can convince the reader that there are many ways of looking at what constitutes conventional wisdom, and if it stimulates the process of enquiry and questioning, it will achieve what is probably its greatest ambition.

1 Understanding Pakistan's Structural Transformation: 1947–2014

This book is about understanding Pakistan's structural transformation over six decades in a political economy framework, where the main purpose is to examine how and where such transformations have taken place, in the economy, in society, in class and gender relations, in manifestations of consumerism and culture, and other dimensions of being in the world, and to assess Pakistan's trajectory of economic and political development over this period.

How does one begin to evaluate the performance of a country over a period of more than six-and-a-half decades? Do we choose some key economic indicators of sixty-six years ago and today, and simply make comparisons, or are there other ways of looking at conditions and situations over more than six decades? Does comparing a snapshot of 1947 with one of 2014, the near impossible task as that is, reveal anything of value, other than the obvious fact that over six decades there has been extraordinary change? And, if it does, we must then ask the more important question: how has that change been brought about? What has been the *process* of development or growth or progress over the last sixty-six years? Perhaps in any evaluation, the story itself, the process and mechanism of change, the directions, developments, and dimensions of the process are the most interesting and relevant factors.

Related to the issue of *how* one looks at change and development, is the critical issue of *what* one is looking at. How can we make the claim that Pakistan today is far better off, at least economically, than it was in 1947, if indeed that is the case, something which increasingly many economists question? Does one use some set of statistics and show that because they are higher/better, so is the country and its people? A snapshot comparison of 1947 with 2014 does not certainly confirm the assertion that Pakistan is very much better off in the second decade of the twenty-first century than it was in 1947. Importantly, it matters also when one is comparing the past with a particular present. For example, many in Pakistan during the 2003–07 false boom period felt that Pakistan's economy had turned around, permanently, and that it was destined for a trajectory similar to India's or even China's, laughable though it now sounds. Moreover, does high economic growth, even if it comes about under military dictatorships—as it so often has in Pakistan—symbolize a future for a country when democracy and participatory forms of government have become the choice of people worldwide? Clearly, *how* one examines a before-and-after situation, *when* one chooses to evaluate such time-lines, *what* one privileges over numerous indicators—economic, social, political, related to justice, peace, etc.—all determine any assessment of a country's development. In many cases, one would argue that many countries are far better off over the last fifty or sixty years, countries such as Malaysia, South Korea, China, India, and even Bangladesh, all have evolved stable and prosperous economies, with most countries in the world having evolved as different forms of democracies. Can one make similar statements about Pakistan which has had a roller-coaster economy, interspersed with extensive and oppressive military dictatorships and praetorian democracy? Even after the first democratic handover between two elected governments in 2013, one is hesitant to predict certainty in Pakistan's democratic prospects at a time when the public discourse still revolves around the question of whether Pakistan is a failed state or a failing one.

The only suitable manner in which a country can be evaluated is to examine its own particular history, and to look at how certain features have evolved through certain processes and the direction in which these developments have taken place. Comparisons with other development processes in other countries are always helpful and welcome, but perhaps a better understanding of one particular country is best told by its *own development narrative*, rather than some general presumed generic laws of development or governance, as has become the global fashion these days. The *story of development* is more important than a mere comparison of the numbers at the beginning with those at the end. However, numbers do provide some insight into the process itself. For example, one can see in absolute and relative terms the *extent* of growth, development and progress that have taken place in the economy, as well as the structural transformation which has taken place—in the economy, society, class structure, in politics—perhaps the single most important outcome showing change. For example, the three-fold increase in per capita income over more than six decades may suggest that, at least according to one important indicator, the people of an area or community are better off and their standard of living in economic and material terms has trebled and that their way of living and being in the world has considerably changed. If the literacy rate has also increased three-fold over the same period, this too shows that the country and its people are better off than previously and now engage with the world differently having a significant impact on social, economic, and cultural relations amongst and between each other.

It is, perhaps, more important to assess what the key numbers and indicators could have become, i.e. the potential—fulfilled or unfulfilled—of the country. While 5 per cent of GNP growth per annum may sound impressive,

perhaps there were conditions which could have meant that the country should have achieved 8 or 9 per cent growth and, hence, 5 per cent suggests unfulfilled potential and expectations. Thus, figures need to be looked at with respect to a potential or trend rate as well. Another relative criterion which could measure success or achievement for a country is some comparison with other countries. If a number of countries were at a similar level of economic development, say, three or four decades ago, and all of them have now shown tremendous growth in absolute terms, it might be necessary to look at how relatively well these countries have progressed. The comparison between South Korea and Pakistan is a much cited case, where both were considered to be at a similar level of development and growth in the 1960s. While both have shown impressive economic growth over the last five decades, today South Korea's GNP per capita is *eighteen times* that of Pakistan. This is, indeed, an extremely telling statistic. Even more telling for Pakistan, is Bangladesh's continued prosperity, both economic and democratic: a country which was called a 'basket case' in 1973, is today being seen as a possible 'next China'. Pakistan, in comparison, has recently been compared with the likes of Somalia, Sudan, and Afghanistan.

While there are a number of important issues that one needs to be aware of when evaluating the record of economic growth over more than sixty years, the story is incomplete, if not inadequate, unless one examines the *consequences* and *results* of economic growth. Does a country with high rates of economic growth measured by per capita income over six decades, with a largely illiterate, uneducated, unhealthy population, reflect progress? And in contrast, does a poorer country with low income growth, but with higher social and human capital, with a literate, healthy, and educated population, represent progress? Or are both measures equally relevant? Pakistan's economic record has always been contrasted with its dismal performance in the social sectors, in absolute terms, and also relative to comparable countries. In contrast, countries like Cuba and Vietnam have economic statistics that seem to be less impressive than those for Pakistan, but both countries have eradicated illiteracy and have statistics in the health sector that are comparable with most developed countries. One must then ask the question: economic development *how* and *for whom*? If economic growth, development, and prosperity are manifest mainly in buying arms, spending beyond one's means on defence, and propping up a large military establishment, all at the expense of expenditure in the social sector and on the people, then no matter how dynamic the economic growth, it is surely quite meaningless. Moreover, the question of equitable distribution of resources is important, where growth in GNP per capita may not be reflected in who or how many benefit from that growth.

It is important to emphasize that the historical moment in which one discusses and evaluates issues that have evolved over time also matters. For example, in the 1950s and 1960s, economic success was dependent almost exclusively upon growth rates, regardless of their composition, distribution, or impact. A high growth rate suggested success, while those countries that had different parameters or priorities and did not come up to some acceptable growth criterion were considered poor achievers, or outright failures. In the 1970s, redistribution with growth and social sector performance became important criteria for success, and now, in the twenty-first century, 'modernization', openness, and indices of involvement and participation of the private sector have emerged alongside growth as important indicators. There have also been important shifts in political ideology and in ways of achieving the targets set. When growth was the only thing that mattered for economists, conventional wisdom held that it did not matter how one achieved high growth, for it would eventually filter down to the people. These economic pundits went so far as to suggest that strong, authoritarian states were necessary to oversee high growth rates and adequate economic performance. Perhaps many of the military dictatorships that emerged in the Third World in the 1950s, 1960s, and 1970s found justification from this argument. The foreign policy and diplomatic manoeuvring of the two superpowers, the United States and the Soviet Union, in those decades reflected this thinking when both countries propped up and supported highly dictatorial and oppressive regimes.

Today, in the neo-liberal era of the new millennium, progress and development incorporate many more qualities than they may perhaps have ever done in the past. Today, economic development must supposedly be *sustainable, participatory, environmentally responsible*, and *distributive*. The single-minded focus on growth has been replaced by a very large number of other, equally important criteria, just as the way of bringing about this growth and development has done, although conventional wisdom still grants, probably incorrectly, that growth matters most. Hence, when we evaluate an economy or country, looking back a few decades, our evaluation is tainted by the times in which we write and by the new conventional wisdom that dominates this historical juncture. No abstract, purely scientific, universal methodology can help in evaluating a long-drawn historical process, and concepts and methods used are relative, contextual, and at times very subjective.

The long preamble above has been made necessary by the need to guard against the pitfalls that afflict us when we evaluate economies or societies, whether our own or someone else's. In the case of Pakistan, it is very easy to adopt a before-and-after approach, showing what was and what is. But an evaluation cannot be even half complete until one studies the processes of economic development, of change, of transition, and of structural transformation, in order to understand where we were, where we are and where we may possibly be heading. Two points in time do not provide that way of looking at society.

This book is about the *process* of economic development in Pakistan since at least 1947, if not a little earlier. This chapter presents a largely static picture of what was and what is. The details of what happened during these sixty-six years are to be found in the chapters of this book. The numbers, the information and the analysis in this chapter, as in the rest of the book, should be studied with caution, and all the arguments listed above, about the dangers of studying and evaluating societies and economies, must be kept in mind.

While the rest of the book talks about the *process* of structural transformation and economic development, about change, about history, and about how these processes unfolded in a dynamic manner, with each specific period or era having different manifestations, this chapter, often simplistically and summarily, presents arguments that are extensively detailed in the rest of the book. The purpose of this chapter, then, is simply to highlight the *extent of change*, rather than the *manner or nature of change* in Pakistan over the last sixty-six years. The other chapters of this book address the latter issue.

1.1 Structural Transformation

Probably the most striking feature that is manifested in a view of Pakistan in 2014 as compared to 1947, is that Pakistan today is less than half of the country it was in 1947. In 1949/50, 55 per cent of Pakistan's population lived in what was then East Pakistan, making it the majority province in terms of population. Despite this majority, the eastern wing was economically discriminated against and exploited. A section of the ruling élite of the western wing of Pakistan became the oppressors and exploiters of the East Pakistani people, leading to their eventual secession after a long and bloody war of liberation ending in 1971.

The contribution made by East Pakistan to Pakistan's economy and society was huge, although never fully recognized or appreciated by West Pakistanis. This point is emphasized in the chapters of this book that look at economic development, industrialization, and trade in Pakistan during the 1950s and 1960s. No matter how significant this loss, post-1971 Pakistan seems to have moved on from the history of its first twenty-five years. However, the mid-point of Pakistan's history seems to constitute a conspicuous break with the past, after which a new country came into existence.

In 1947, Pakistan had every right to be called an 'agricultural' country. Unfortunately, most students of economics make the serious mistake of still calling Pakistan an agricultural country 66 years later, when there is no justification for doing so. At the time of independence, the major share of (West) Pakistan's gross domestic product was from agriculture, which contributed around 53 per cent, compared to 7.8 per cent from manufacturing and 11.9 per cent from retail trade. More than 65 per cent of Pakistan's labour force worked in agriculture and almost all of Pakistan's exports consisted of primary products, essentially agricultural commodities like jute and tea, which, not surprisingly, originated from East Pakistan (see Table 1.1 and Figure 1.1, and Chapters 6 and 9).

By 2013 the extent of change in Pakistan's economic structure can also be seen in Figure 1.1, and the cliché that Pakistan is basically an agricultural country is no longer true. Now, agriculture contributes a mere 21 per cent towards GDP, while manufacturing is as high as 21 per cent. The services sector has replaced agriculture as the dominant sector of the economy, contributing more than half of the total GDP. The population employed in agriculture has also fallen, although at around 45 per cent of the total labour force, agriculture is still the biggest sector in terms of the employed labour force. More importantly, the nature of exports from Pakistan has has also changed dramatically. From 99.2 per cent of total exports in 1947, primary commodities now constitute only around 15 per cent. However, one must emphasize the fact that although 85 per cent of Pakistan's exports are now manufactured goods, with textiles, garments, and yarn making up most of them, these figures are less impressive when we realize that most of Pakistan's exports still depend critically on raw cotton. Another important change related to the agricultural sector is the recent trend of the huge growth in non-farm or non-agricultural, rural, employment and income sources. The non-farm business sector and remittances may have now become the most important economic activity and input into the so called 'rural' economy.[1]

These economic changes in structure are also manifested in where people live. In 1951 when the first census in independent Pakistan was held, only 17 per cent of West Pakistanis lived in areas designated as urban; today estimates suggest that at least 60 per cent live in cities and towns, with perhaps Punjab as much as 70 per cent urbanized, depending on how we define 'urban'—see Chapters 26 and 27.[2] This shift has major repercussions for the economy, society, and the political process under way. In fact, in the context of Pakistan, perhaps the most important political factor over the last few decades has been the process and extent of urbanization and the emergence and consolidation of a middle class (see Part IX for further discussion on this issue). With more than 60 per cent of the country's population living in cities and towns, the economic profile, in terms of consumption and production patterns, has also changed quite dramatically. Urbanization's impact on social and economic development is also very significant. The extent and process of urbanization used to be considered as an indicator of progress and modernization. Although many modernizers and developmentalists no longer hold that this assumption is valid, one cannot overlook the significant structural change that has been brought about by the process of urbanization in the last 66 years, from only 6 million inhabitants out of a population of 33.8 million in 1947, to more than 110 million who now reside in cities and towns. (The implications of this change are discussed in Chapters 26 and 27.)

Just as the cliché that 'Pakistan is an agricultural country' is repeated *ad nauseam* by students of Pakistan's economy, another myth that prevails and is related to the earlier one is that 'Pakistan is a feudal country', sadly a myth perpetrated by foreign correspondents and academics on visits to Pakistan.[3] No matter how one looks at the facts and observes the manner in which society has evolved, there is no justification for believing, let alone repeating, what is perhaps Pakistan's most popular myth. By any set of criteria, there is no evidence to support this illusion. The Green Revolution of the 1960s, with its extraordinary impact on the rural areas, agriculture, the economy, and the social relations of production, put an end once and for all to the myth that Pakistan was a 'feudal' country. Chapters 2 to 5, on agriculture in Pakistan, re-emphasize this point using different criteria. Chapter 26 re-examines the issue of feudalism, asserts once again that it is no longer of any consequence, and then goes on to examine the implications of this understanding in Chapter 27. If in 1947 there were suggestions that Pakistan was a feudal

Table 1.1
Pakistan: Basic Indicators, 1947–2014

Pakistan is the world's sixth most populous nation, and has the 40th largest economy in terms of GDP, although in terms of purchasing power parity, Pakistan's economy is the 24th largest in the world. However, it is number 164 out of 203 in terms of GNP per capita, and the 146th worst performer out of 190 countries, in terms of a composite United Nations Human Development Index.

I	Population (millions)	33.78	(1951)[1]	150	(2004)	185	(2014)
	Urban (%)	17.8		40.0		60–70	
II	Contribution to gross domestic product, by sector (%)	1949/50[2]		2002/3[3]		2012/13	
	1 Agriculture	53.2		23.6		21.4	
	2 Manufacturing	7.8		25.7		20.9	
	3 Others (mostly services and trade)	39.0		50.7		57.7	
	Labour force, by sector (%)	1950/1[2]		2003[3]		2012/13	
	1 Agriculture	65.3		48.42		45.1	
	2 Manufacturing	9.5		18.03		13.7	
	3 Others (mostly services and trade)	25.2		33.55		41.2	
III	GNP per capita (US$)	170	(1976)[4]	440	(2000)[4]	1368	(2013)[6]
	Per capita income (Rs) constant factor cost (1959/60)	350	(1949/50)[5]	915	(1992/3)[5]		
	PPP real GDP per capita (US$)	820	(1960)[4]	1,928	(2000)[4]	2891	(2012)[6]
IV	Composition of exports (%)	1951/2[2]		2002/3[3]		2012/13	
	1 Primary commodities	99.2		11		15	
	2 Semi-manufactures			14		16	
	2 Manufactures			75		69	
V	Primary schools (number)	8,413	(1947/8)[1]	164,200	(2002/3)[3]	153,900	
	Literacy (%)	15	(1951)[1]	42	(2002/3)[3]	58	(2011/12)[7]
	Female literacy (%)	12	(1951)[1]	29	(2002/3)[3]	47	(2011/12)[7]
VI	Life expectancy (years)	43	(1960)[4]	63	(2002/3)[3]	65.7	
	Infant mortality rate	137	(1960)[4]	83	(2002/3)[3]	59	
	Access to safe water (%)	29	(1975)[4]	88	(2000)[4]	92	
	Access to sanitation (%)	14	(1980)[4]	61	(2000)[4]	48	
	Total registered doctors	1,014	(1948)[1]	101,635	(2003)[3]	160,289	
	Population per doctor	14,835	(1951)[1]	1,466	(2002)[3]	1,127	

Sources: 1. Government of Pakistan, *Twenty Five Years of Statistics in Pakistan, 1947–72*, (Karachi, 1972); 2. Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984); 3. Government of Pakistan, *Pakistan Economic Survey 2002–3*, (Islamabad, 2003); 4. Haq, Mahbub ul, *Human Development in South Asia, 2002* (Karachi: Oxford University Press, 2003); 5. Malik, Sohail et al. *Pakistan's Economic Performance, 1947 to 1993: A Descriptive Analysis* (Lahore: Sure Publishers, 1994); 6. World Bank website. 7. For 2013, most of the data is from the *Pakistan Economic Survey 2012–13* (Islamabad; 2013).

country, long before the Golden Jubilee Celebrations took place in 1997, all the evidence pointed to the contrary. While feudalism in Pakistan died a very long time ago, modern-day Pakistan has also seen the demise of agriculturists as a powerful economic, social and political force. The huge change in economic, social, and hence political power, from the agriculturist, so-called feudal, lobby towards an urban and rural middle class, is probably one of the key indicators highlighting the extraordinary structural transformation of Pakistan in over six decades.

1.2 Decades and Epochs

The sixty-six years since 1947 can be distinguished by numerous epochs or eras, which represent different economic policies and planning and management arrangements. The first eleven years, between 1947 and 1958, are the years when the country and economy were trying to settle down, but to no avail. This period was followed by what many still call the golden era of economic development (or at least economic growth) in the Decade of Development under Ayub Khan. The economy and the political scene had indeed stabilized and settled down, with the result that growth rates were unprecedented, and Pakistan was considered to be one of the few countries at that time which would achieve developed country status. With the war of liberation in East Pakistan, the majority wing left Pakistan to form Bangladesh and two new countries, not one, were born.

Post-1971 Pakistan was a new country in every respect, compared to the one that had existed between 1947 and 1971. The third brief, albeit highly significant era in Pakistan's

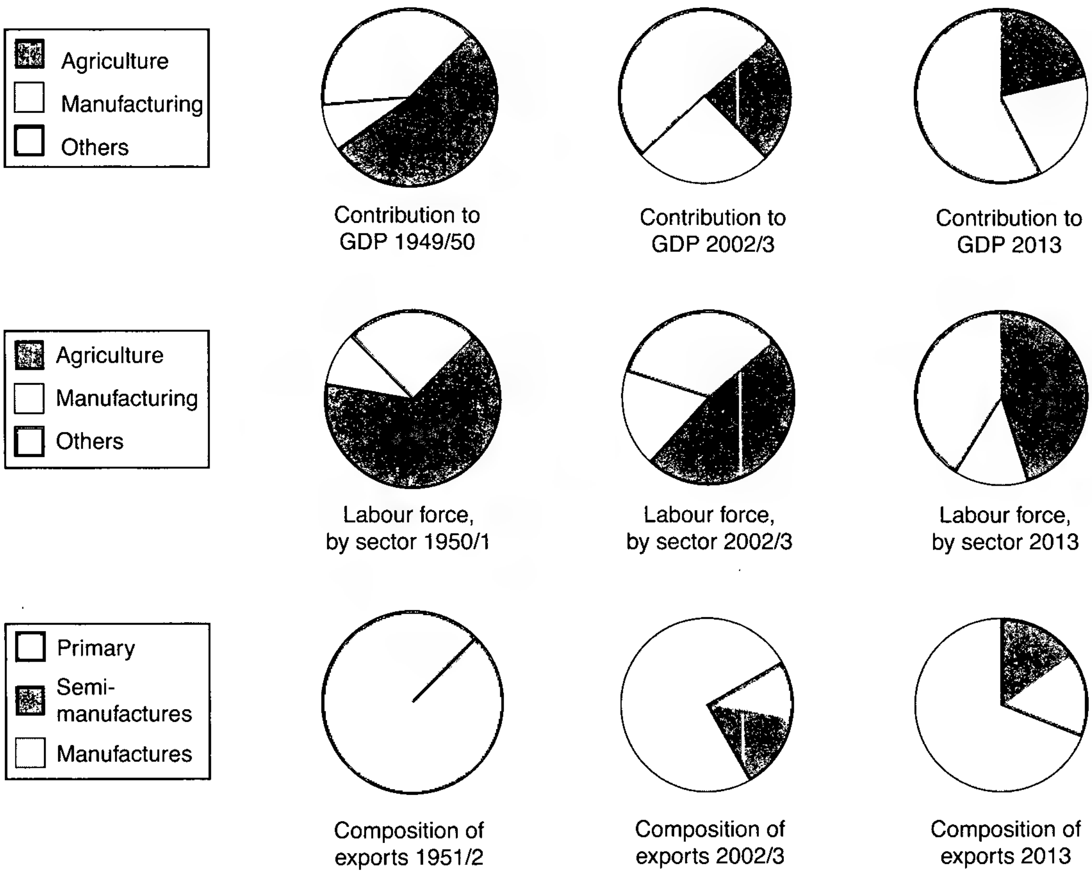

Figure 1.1: Structural Change in Pakistan: 1947–2013

history, was the five-and-a-half year period of Zulfikar Ali Bhutto. His populism or Islamic Socialism, or just plain rhetoric, made him the most popular, and at that time the only elected leader to emerge in what was left of Pakistan. His rule ended with the imposition of Pakistan's second martial law under General Zia ul-Haq in 1977, perhaps the most brutal of all three, which changed Pakistan for the worse, perhaps irreversibly, with connotations and repercussions which continue well after three-and-a-half decades. There were some similarities between the first and the second martial laws (discussed in detail in later chapters), but the world was now a very different place compared with the 1960s. The opening up of the Middle East, the first Afghan war (with its consequences of a drugs and arms culture in Pakistan), attempts at the Islamization of the economy and society, and a praetorian democracy between 1985 and 1988, were amongst the salient features of the Zia era.

The death of General Zia in many ways once again, brought about the end of the old Pakistan, and 1988 signalled the third birth of the nation after 1947 and 1971 (see Chapters 26 and 27 for far greater details about the evolution of society after 1988). While political and social changes were fast to emerge, the post-1988 economic changes and programmes also represented a departure from the past, with very significant impacts on society, many of which were highly deleterious.

Yet another military coup in 1999, which brought General Pervez Musharraf to power, in some ways, ended the complex political, civil, and military arrangement that had existed since 1988. The return of the military directly into politics after 1999 implied considerable change compared to the 1988–99 period. Moreover, after 9/11 with the world economic and political map redesigned, the world, our region, and domestic economic and political arrangements, have all been markedly affected (see Chapter 18, and Part IX for these issues). Political and economic changes in 2007 and 2008 signalled hope and optimism in many ways, but also demonstrated abject failure and mismanagement during the 2008–13 democratic transition. Elections in 2013, the first without direct military involvement, signal possible departures, although making predictions in Pakistan is an unwise, if highly popular, pastime.

This section very briefly presents the main features, achievements, and consequences of the many epochs in the sixty-six years since Pakistan's independence. As will become clear, especially with reference to the later eras, 'independence' and 'sovereignty' are words that have little meaning in a country that celebrated its Golden Jubilee of Independence some years ago.

Table 1.2: Growth Rates in Pakistan (Average Annual %)

	1960s	1970s	1980s	1990s	1999–2002	2003–2008	2008–2012	2000–2010	2013P
GDP	6.77	4.84	6.45	4.6	3.29	6.83	2.78	4.7	3.6
Agriculture	5.07	2.37	5.44	4.4	1.49	4.09	2.3	3.2	3.3
Manufacturing	9.93	5.50	8.21	4.8	4.84	9.69	0.45	7.1	3.5
Commodity producing sector	6.83	3.88	6.49	4.6	2.32	5.99	2.28	4.3	3.4
Service sector	6.74	6.26	6.65	4.6	4.25	6.50	3.43	5.1	3.7

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: Various issues).

1.2.1 Laying the Foundations: 1947–58

In 1947, Pakistan was, indeed, a predominantly agrarian, undeveloped, newly independent nation, with little industry, few services, and no infrastructure. In the first few years, Pakistan's main concern was one of survival, where adverse international conditions and a precarious domestic situation, with millions of refugees, made the provision of very basic necessities the primary task of the government. Attempts to restructure the economy and to ensure that it was on a strong footing could be undertaken only after the initial political and economic shocks had been dealt with.

The first decade of economic policy and planning witnessed the attempts of a bureaucracy to keep Pakistan on its feet. The herculean task of building an economic base was left to the state sector as the private sector was still in an embryonic state and did not have the capital to lead an industrial revolution in the country. It was the windfall gains made by the mercantile class during and after the Korean War in 1952 that paved the way for the foundation of industry, an industry which the state sector helped develop and then handed over to the private sector.

1.2.2 The Decade of Development: 1958–68

If one examines Pakistan's economic growth record, the 1960s stands out as the decade with the best performance. Table 1.2 gives a useful indication of the nature of the differences between the 1960s, 1970s, and 1980s. While the rates of growth for the 1960s and the 1980s seem to be quite close in most categories, there are important conceptual and ideological differences in the modes of development under the two military regimes.

Curiously, the 1960s has been termed a 'controversial' decade for the type of economic policy pursued, and the resulting economic and political effects. Dozens of economists and social scientists have written about Ayub Khan's era, and they are generally agreed that considerable economic growth and development did indeed take place. They argue that significant leaps were made in industrial and agricultural production, where growth rates in excess of 20 per cent per annum were witnessed in the large-scale manufacturing sector. In the first five years of the Ayub rule, manufacturing grew by as much as 17 per cent, and in the second half of Ayub Khan's rule, agricultural growth increased by 6 per cent, while industry grew by 10 per cent. Table 1.2 shows that the economy in general, and the different individual sectors, grew by phenomenal rates, and Pakistan was considered to be a model capitalist economy in the 1960s.

The controversy surrounds the eventual effects and results of this phenomenal growth rate. Observers have pointed out that this aggressive capitalist development caused serious economic, social, and political tensions. They argue that there was increased disparity in incomes across different regions which was manifest in the concentration of economic prosperity in both the industrial and agricultural sectors in central Punjab, and in industry in Karachi. Critics of Ayub Khan's model of development point out that these two regions were permitted to grow at the expense of the rest

of the country, and the end result was the feeling in East Pakistan of utter neglect and betrayal. Apart from the very obvious phenomenon of regional disparities, a number of scholars also took pains to show that there was a great deal of economic concentration amongst individuals, and that numerous business empires were created. This, they showed, resulted in increasing income inequality.

Of course, all this did happen. There was tremendous growth, but there was also increasing disparity across classes and regions. The social sectors were also neglected. There was little or no increase in the level of real wages, and social equity was of little concern. Functional inequality was the preferred philosophy of Mahbub ul Haq and Ayub Khan's Harvard Advisory Group, and their focus was on the rich, who were supposed to generate more savings, and thus were to be the motors of capitalist growth and development.

It is surprising that economists and social scientists were so surprised and upset at what had happened during Ayub Khan's rule. What would have been surprising was the *lack* of this 'controversial' and contradictory development. Capitalist development, especially in the manner in which it was implemented in Pakistan at the time, implied unequal development, and to have expected otherwise is naïveté. There is a need now to examine the Decade of Development afresh. The consequence of Ayub Khan's economic policies was that there was growth and development, the forces of production did expand, a proletariat was born, and compared to the earlier periods, this was indeed a very progressive era in the evolution of the economic and political process of Pakistan. The 'controversial' repercussions were inherent, inbuilt, and inevitable.

However, what is most interesting about Ayub Khan's era is the fact that the economic package was thoroughly illiberal, and was almost the opposite of what is being termed economic liberalism today. It was capitalism, and the private sector did play a significant role, but it was the guided, bureaucratically-governed and directed capitalism, perhaps a benevolent state capitalism, of a developmentalist state. The bureaucracy played an active, influential, and constructive role in the establishment of private sector capital in Pakistan. The dozens of constraints on setting up industry, red tape, and numerous hurdles in financial and industrial policy did not stop the impressive growth in this period. The nature of the economy was precisely what it should not have been according to the doctrine of economic liberalism and liberalization. Trade was highly controlled and closed. The exchange rate was overvalued, and it distorted local markets. Financial capital was rationed, and the stock market was a playground for a handful of people. The government's presence was everywhere, directing and encouraging the private sector and the market. The agricultural sector was consciously identified by the government as a vehicle for growth, and numerous (governmental) decisions were taken which resulted in growth at times in excess of 11 per cent per year. The transformation of the agricultural sector from a pre-capitalist to a capitalist stage was accelerated by active involvement and interference by the government. Even public sector projects commissioned by the Pakistan Industrial Development Corporation (PIDC) were gifted away to the private sector. The bureaucracy, in essence, gave birth to the private sector capitalist in Pakistan—indeed—a very illiberal process according to the conventional wisdom.

1.2.3 The Bad Luck Years: 1971–77

Ironically, while most intellectuals condemned Ayub Khan's policies, it was these policies which gave rise to populism and the brand of policies particular to Zulfikar Ali Bhutto, who was supported by the same intellectuals. Without Ayub, Bhutto would not have been possible. Bhutto's economic policies were more illiberal than those of his predecessor, and his nationalization was said to be the major cause for a huge downward trend in growth. However, Table 1.2 shows that in the 1970s GDP grew by close to 5 per cent, which indicates the need, as in the case of Ayub, for a thorough re-examination of the economic programme of Bhutto.

Bhutto's economic programme has been labelled a failure by his critics, and even his supporters have, under the barrage of propaganda and the changed world situation, at best been apologetic and at worst have joined the maligning chorus. In many ways he was an unlucky politician, and events beyond his control affected his economic programme. The economic loss of East Pakistan was strongly felt—West Pakistan 'exported' 50 per cent of its goods to the eastern wing and acquired a large amount of foreign exchange from its raw material exports. The devaluation of the Pakistani rupee by 120 per cent in May 1972 brought significant dividends in terms of export growth—in one year (1972/3) despite the loss of East Pakistan's exportable produce, West Pakistan doubled its foreign exchange earnings. However, the 1973 OPEC price increases played havoc with Pakistan's import bill and the balance of payments deteriorated. Also, the period after 1973 saw a serious worldwide recession affecting Pakistan's exports. Recurrent domestic cotton crop failures and floods in 1973, 1974 (along with pest attacks), and 1976 affected Pakistan's main exports. The large nationalized units taken over by Bhutto were the most inefficient in the industrial sector and, despite nationalization, industry experienced a reasonable growth rate, with the nationalized sector doing better than most believe.

Bhutto's government also laid the foundations for future growth and development from which his successor benefitted. Basic industries were set up and a base for a capital goods industry was established, which resulted in subsequent growth. The Middle East boom which Bhutto initiated, in another ironic twist, helped keep Zia in power for some years. The illiberal economic policies of Zulfikar Ali Bhutto were responsible for growth not only during his own tenure, but also in the period after 1977.

1.2.4 The Second Military Government: 1977–88

General Zia ul-Haq's regime was more liberal in economic terms—though certainly not politically—than any of his predecessors. While the civilian-military bureaucracy played a prominent role in acquiring capital and in assuming the role of entrepreneur and financier, numerous individual

capitalists emerged in the stable post-Bhutto era. High rates of industrial growth were led by the coming on stream of the earlier investment made by the public sector under Bhutto, especially in heavy industries, and also by a rapid expansion in domestic demand. While the trend to liberalize the economy was escalated consciously in the Zia period, the Soviet invasion of Afghanistan and the excessive involvement in Pakistan by the USA helped ensure that steps were taken to increase growth. Remittances from the Middle East and aid from abroad helped launch Pakistan's second economic revolution, where the middle class emerged as a formidable economic and political category. By becoming the capitalist world's 'front line' state against all things Soviet, and especially against Soviet expansionism in the region, Pakistan's government gained in terms of financial aid and resources. However, General Zia's martial rule inflicted deep-rooted damage to Pakistani society, creating intolerance and instituting violence, from which it still suffers.

1.2.5 Neo-liberalism, Structural Adjustment, and Praetorian Politics

The period after the death of General Zia in 1988 resulted in the return of not democracy, but a manipulated (by the military and its secret agencies) form of electoral politics to Pakistan. Between August 1988 and August 1997, Pakistan had four general elections, with both Benazir Bhutto and Nawaz Sharif being returned to power twice, with active involvement by anti-democratic forces determining political outcomes. While in 1988 many academics and observers felt that this may have been the beginning of a post-military, democratic transition in Pakistan, they were very wrong in their assessment about the nature of the control, power, manipulation, and intrusion of Pakistan's deep state, revelations which were formally revealed to the public as late as 2012 and 2013. None of the elected governments were able to complete their full term due to the persistent involvement of the military and its junior partner, the bureaucracy. There were also more than a few 'caretaker' governments, of which the last two in particular, headed by Moeen Qureishi (a retired World Bank Vice President) and by Meraj Khalid were very controversial. However, while the post-1988 period could, in 1988 (now incorrectly), be termed the 'Period of the Return to Democracy', it was more the manipulation of political actors, and it could better be called the 'Era of Neo-liberalism and Structural Adjustment'. We argue later in this book that, rather than the electoral process, it was this particular economic programme and process which determined the course of Pakistan from 1988 onwards. Furthermore, while the electoral political transition was arrested in October 1999 yet again, the economic policies continued even more vigorously. The process of liberalization, openness, privatization, and market friendliness continued unabated regardless of the visibly noticeable damage caused.

Since 1988, Pakistan's economy has been under the tutelage of the international lending agencies, the IMF and the World Bank. Economic policies, labelled 'economic liberalization, stabilization, and structural adjustment', evolved in Washington have been imposed upon a hundred countries worldwide, with Pakistan and its governments amongst the most enthusiastic adherents to the Washington Consensus. Moreover, Pakistan's governments have taken the art of subservience to new depths: an examination of World Bank and IMF documents since 1988 reveals that almost every decision of any consequence taken by the various governments that have been in power has been predetermined by the two Washington agencies, and that Pakistan has merely followed diktat. This is evidenced also by the fact that in the 1990s, Pakistan seldom found the need to appoint a full-time Finance Minister, as numerous advisers on loan from the World Bank and the IMF ensured that implementation was thorough. While this blind adherence to Washington has meant a loss of sovereignty for the Pakistani state and its people, the outcome of these policies has had serious consequences for the economy overall, and for individuals—see Part VI of this book for more on the Structural Adjustment Programme in Pakistan. In 2008 and 2013, both democratically elected governments, once again, enthusiastically approached the IMF for large loans, ostensibly on the basis of 'home-grown' programmes, with neo-liberalism now the official creed of all political parties in Pakistan.

1.2.6 Lifestyle Liberalism, Dictatorship, War, and Subjugation: 1999–2007

While Pakistan's economic programme has been supposedly one of a 'liberal' economic tenor, with the state receding and markets apparently presumed to be free since 1988, its politics was far from liberal in the 'lifestyle liberal' era during General Pervez Musharraf's military dictatorship embraced by Pakistan's undemocratic liberals and elite.[4] Seizing the opportunity to support a lifestyle liberal General, many members of Pakistan's civil society and political class who had struggled for democracy in Pakistan earlier, were quick to become part of the team of the individual responsible for Kargil in 1999 and who overthrew an elected Prime Minister. The choice being made in 1999 was falsely construed as one between an Islamicizing elected government, deviating even from basic electoral protocol, to an overtly socially liberal, 'moderately enlightened', military general. Democracy was inconsequential in 1999 to Musharraf's supporters, and for them something packaged as 'liberalism' mattered far more. This was 1999.

In 2001, the world changed and Pakistan was caught up in the War Against Terrorism once again. Musharraf, who had become popular at home after ousting Nawaz Sharif in 1999, was considered a pariah by the international leadership in his first two years. The economy was doing badly, as it had under General Zia in 1977 until the Soviet invasion of Afghanistan granted Zia a longevity he could not have imagined when he overthrew and murdered Zulfikar Ali Bhutto. General Pervez Musharraf was rescued by the events following 9/11 and another invasion of Afghanistan, in 2001, this time by the Americans. The economy boomed under a false cocktail of aid from the US, IMF, and other global economic support—see Chapters 18 and 25—and Musharraf, backed to the hilt by the US, particularly President George W Bush, was granted a

longevity. The US support ensured, as it had in the 1960s and 1980s, that Pakistan would continue to be ruled by a military general.

Yet, it would be puerile to blame the US for everything that has gone wrong in Pakistan, although blame is certainly warranted. Just as Pakistan's political elite has been responsible for allowing the IMF to run Pakistan's economic policy, and the IMF cannot be held responsible for Pakistan's leadership running to it every few years for its reluctance to undertake urgent reform, its political class has also, at least in the past, been responsible for supporting military authoritarianism and dictatorship. It was opposition parties who welcomed Musharraf and who continued to support his lifestyle liberal, praetorian election charade, and the US simply joined and strengthened the chorus. Pakistan's political class and its civil society were to blame equally for Musharraf's longevity—see Chapter 26. With the economy booming, and Pakistan a non-Nato ally, Pakistan's elite was happy to support Musharraf's electoral shenanigans without much active hostility. In fact, as Chapter 26 reveals, the argument was also made here that perhaps Pakistan's elite did not want a messy democracy and preferred a lifestyle liberal, military-dominated electoral process which allowed some symbolic representation. Clearly, one was wrong, and numerous events in 2007 proved how brittle the boom in the economy was, and how unstable the authoritarian order had become.

1.2.7 Another Democratic Transition? 2007 Onwards

Numerous events in 2007, once again, changed the course of Pakistan's political trajectory as the hold of the Musharraf regime weakened and he made numerous decisions which led to his downfall. The reprimand of the Chief Justice of Pakistan, a military attack on the Lal Masjid in Islamabad, and subsequently a clampdown on the very active media leading to an Emergency in the country, all in 2007, undermined any sense of stability the regime may have displayed. In particular, it was the Lawyers' Movement of 2007, that led the main challenge to the Musharraf regime, as the term of his elected parliament came to an end and elections were inevitable. Political deals cut between the military General and the likely prime ministerial candidate, Benazir Bhutto, suggested a more controlled electoral transition, with the former as President and she as his Prime Minister. However, 2007 ended with the assassination of Ms Bhutto resulting in Pakistan's freest and fairest democratic elections since 1970, with Ms Bhutto's party returned to power. Eventually, Musharraf was forced out and handed power to Pakistan's first democratically elected civilian government in four decades, although he still remained President of Pakistan.[5]

While the Lawyers' Movement was one of the many forces which resulted in democracy returning to Pakistan, other factors made an important contribution. The rise of a free media which was aggressive, often brave, and surprisingly even pro-democratic, played a key role in pushing Musharraf's military dictatorship away, as they did in later years when democracy was threatened from the inside.[6] Opposition parties, particularly those which had supported military intervention in the past, had also learnt their lessons and made commitments to furthering the cause of democracy in Pakistan rather than exploiting weaknesses to push their own agendas. Even the Supreme Judiciary, which had in years past endorsed every authoritarian and dictatorial decision by every military dictator, refashioned itself as an activist judiciary against military arbitrariness. Much had seemed to have been learnt by the political class in many years in exile and isolation, and democracy became an audible slogan championed even by right wing Islamist parties.

Yet, the 2008 democratic transition was weak, cautious, rapacious, and incomplete. The civilian government failed to mark its imprint on the political process through fear and incompetence, despite the fact that it had many opportunities to do so. The Osama bin Laden killing and Abbotabad raid, the attack on the Mehran Base in Karachi, and the military's many weaknesses which gave the civilian government ample opportunity to enforce its authority, were not exploited. Democrats did not know how to consolidate democracy, although given the opportunities to do so; however, one must admit that just staying on in power for five years for the People's Party government, given constant intrigue and threats from the 'Establishment', was itself a major achievement. While democracy may not have been substantially strengthened during the 2008–13 period, the fact that it persisted might be the main achievement of the last decade which allowed a subsequent transition to take place in 2013.

1.3 Transformation and Development: The Balance Sheet

This book is about the process of structural transformation and economic development in Pakistan over the last sixty-six years, and is devoted to understanding how, why and under what conditions that process has taken place. The summary presented in section 1.2 is an extremely brief condensation of a few of the ideas that constitute this book, and should not be seen as an alternative to the more detailed story that follows. Having presented an introduction to the main epochs in the first six decades of Pakistan's existence, in this section we try to examine the issue of whether Pakistan's six decades of economic growth, development and transformation can be called a success or a failure, or whether, as is often the case, the answer lies somewhere in between.

For most of Pakistan's sixty-six years, the economy has shown healthy growth around a trend rate of nearly 5.2 per cent per annum, although the overall trend has been falling since 1988. There have been years where the rate rose to even more than the trend rate, and other years when it fell to less than even half: it was an abysmal 1.7 per cent in 1996/7, perhaps the lowest of all time at that juncture, and fell to only 0.4 per cent in 2008/09. If an evaluation of Pakistan's economy had taken place in 1968, for the most part, based on economic growth criteria, one would have called it a resounding success. Indeed, the government of Ayub Khan called its era the 'Decade of Development'. An evaluation of Pakistan's first quarter-century, in August 1972, would have

looked at the country's history differently, Pakistan having lost its eastern wing and having suffered the consequences and contradictions of the Decade of Development, which were manifested in late 1968 just as the government of the day celebrated its pyrrhic victory. Success and failure are, clearly, highly relative terms.

Even if the growth rate of Pakistan has shown impressive trends, what has been the consequence of that growth? Does Pakistan produce most of its products, or is it now a highly import-dependent economy? Many countries of the world depend on trade and on imports. Is it of any consequence that Pakistan is a member of that group? The nature and quality of output and the conditions under which it is produced are also important. Moreover, can one grant a country any measure of success when it is chronically dependent on either bilateral or multilateral aid?

One also needs to compare Pakistan's performance with that of other countries to see if Pakistan has done as well (or as badly) as its own data show. Five per cent growth per year, even in simple terms, sounds commendable. But countries with similar initial conditions to Pakistan experienced growth rates that were higher, more consistent, and longer lasting than Pakistan's 5 per cent. Many of those countries now rank among the newly industrializing countries (NICs), while Pakistan is currently the thirty-ninth poorest nation out of 203 classified by the World Bank, using GNP per capita as the main criterion (see Chapter 19 for further discussion of this issue). In terms of human and social capital, the United Nations Development Programme (UNDP) ranked Pakistan 120 in 1991 ahead of (better than) India, 123rd and Bangladesh, 136th. In 2003, Pakistan was ranked 144, way behind India (127) and even Bangladesh (139). Within two years (2001–03), Pakistan's ranking fell from the 138th position to the 144th. Transparency International, a German research institute that analyses society and politics around the globe, in 1996/7 ranked Pakistan as the second most corrupt country in the world after Nigeria, a position which improved somewhat in 2013, but is still embarrassingly poor. Hence, by what measure does one compare or classify success?

One can list tables of numerous indicators showing their trend over the last six decades. For example, in 1947 there were 8,413 primary schools in the country, of which 1,549 were for girls. By 2012 the number of primary schools had increased to 157,200, a rise of almost twenty-fold. Girls' schools had increased by a factor of forty-five in this period. On paper these statistics indicate major achievements, but has the quality of education improved at all? Can one say that the twenty-fold increase in education facilities reflects at least a three or four-fold improvement in the quality of education? The answer is probably in the negative. Indeed, many people would feel that, despite the increase in quantity, the *quality* of public sector education has made a noticeable downward shift. However, the increase in the number of educational facilities has allowed a larger number of people to have access to whatever education is available. Quite possibly, children of poorer families and those in the lower income groups may have had their first opportunity ever to send their children to school. This change in the social and economic profile of schoolchildren must count as some measure of success. However, the fact that the quality ought to have been far better and that the results of education, literacy, scientific skills, etc. far more extensively spread amongst the population, suggests that it may be only a small measure of success. While it is usual practice to show how numbers have increased over the years, one must look at such trends and 'evidence' with great caution.

Another measure of success is the extent of autonomy, sovereignty, or independence that a country acquires. After sixty-six years, such criteria should be of less importance than when a country has been newly created and is trying to find its feet. Section 1.2 shows, however, that after 1988 any semblance of sovereignty and independence that Pakistan may once have had has been lost—although, it really hasn't had much earlier either. Today, Pakistan is a highly aid-dependent economy with multilateral institutions and foreign governments playing a dominant role in both the political and economic affairs of the state, even after six decades of political independence. While other countries have also made use of aid and loans, they have used that money for development purposes, unlike Pakistan, where much of the assistance has been squandered, often in dubious circumstances and through illegal and illicit channels. Moreover, events following 9/11 have revealed further weaknesses in Pakistan's political structure with regard to foreign domination.

Six decades are a fairly long time for countries to change and transform their economic and social systems. Given even a semblance of sensibility in a nation, with an elite that has the desire to improve even only itself, in sixty-six years much can be expected to change. Pakistan has had much more than just a bare minimum of endowments and resources, and has achieved far more than a bare level of subsistence. Living standards have improved manifold over the last six decades, and more so during the latter half of this period. Numerous factors have been responsible for this growth, some fortuitous, most consciously sought after. In some ways the growth/development/progress that has taken place has been unremarkable, because it was almost inevitable, given initial conditions. Even without all the effort that was made to influence and direct policy, growth and development would have taken place. The only contentious issue is the degree, extent, and form of that growth and development, and the extent to which it fulfilled prospects and potential.

There are also economic and social costs and consequences of development and growth. Since growth has been the overriding aim of governments in the past, and as it is probably the statistic that most impresses politicians, planners, and economists, any negative ramifications of this single-mindedness have been ignored. Environmental degradation is now considered to be the most serious repercussion of this strategy, with pollution and the decay of natural resources quite rampant. Urbanization, which has a great many advantages, also brings with it greater demands on basic facilities and infrastructure, which cannot be provided to all. The result is squalor and poor and unhygienic living conditions for the large majority of people who live in cities, not always out of choice. For urban residents in Pakistan, rich and poor alike, the deteriorating law and

order situation, offering no protection for life or property with the state having virtually collapsed, is possibly the most important and immediate negative consequence of inequitable growth. Many Pakistanis would question the claim made by statisticians and others, on the basis of high growth figures, that Pakistan has made huge progress; for these people, lower growth with more personal security and freedom is probably a preferred alternative.

Pakistan's economic development has been a capitalist development, where the private sector has played a key role. In the early days, the state played the critical role in establishing industry and assisted the private sector, but in more recent years as the role of the state has diminished, private sector-led growth has been the norm. However, Pakistan's capitalist path of development has been unusual for reasons which are discussed at different times in this book, and especially in Chapters 26 and 27. Pakistan's has been a very crude, peculiar capitalism, much influenced by the country's history and culture and the formation of social, economic, and political classes. The excessive amount of corruption, rent-seeking, and clientelism in Pakistani society is both responsible for and a product of the specific nature of Pakistan's development. On many other counts too, Pakistan has been an abject failure. The inability to evolve a state which can protect its people, or a political and civil society class which believes in the strengthening of democratic norms and practices, or a society in which different views, especially religious views, are given tolerance and space continue to be absent or weak in Pakistan. Many countries undergoing economic development and structural transformation similar to Pakistan's, have addressed and resolved such contradictions, but not yet Pakistan. It is not possible to speculate about what would have happened if it had had less corruption and had been more honest, for these are counterfactuals. Pakistan would not be what it is today—for better and for worse—had it not evolved in the way it has, an evolution much determined by given material conditions, existing and past.

1.4 Conclusions

Pakistan's economic development and social change over its first sixty-six years is spectacular, yet commonplace, and in many ways tragic. Compared to what it was in 1947, the country seems like a modern, dynamic state—unlike, say, Afghanistan. Compared to other countries, such as the south-east Asian countries of Malaysia, Thailand, and South Korea, Pakistan's achievements look minuscule, and numerous indicators of failure emphasize such distancing. Pakistan would necessarily have grown from whatever existed in 1947, as the country had skilled labour and sufficient natural endowments. It could have grown much more, given its own potential and the performance of other comparable nations. Although important directions can be given to the process of history governing nations, and critical decisions can have dramatic consequences, either positive or negative, there is a logic to history itself that governs and determines the course of society and of nations. Comparisons with other countries to deduce 'what could have been done' or how to go about development, often ignore elements of *specificity* and *contextuality* on the one hand, and chance and randomness on the other. Many events in history, outside the control of those whom they affect, have altered the course of nations, and we see that far more in the case of Pakistan than many other countries. Hence, comparisons and evaluations need to be considered in relevant contexts, given specific histories.

Yet there are generalities as well. All nations belong to, and are part of, the global economy, and increasingly so. They cannot avoid the influences—both negative and positive—of this integration. Their destinies are often closely linked with those of others, and by being part of the world order, they have the ability to learn much more from each other, and at a greater pace. With the communications revolution, physical integration is no longer essential, and influence and trends cross political borders, bringing markets and people together. Comparisons and attempts to emulate become easier.

Table 1.3: Pakistan: Indicators of Failure

	%	Latest Year	Source
Illiterate adults	44	2009	Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2012* (Lahore: Oxford University Press, 2012).
Illiterate female adults	60	2009	Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2010–2011* (Lahore: Oxford University Press, 2011).
Population below national poverty line (%)	22.3	2011	*Basic Statistics 2013* Asian Development Bank, (Manila, 2013)
Population below US$1.25 a day (PPP) (%)	21	2010	*Basic Statistics 2013* Asian Development Bank, (Manila, 2013)
Without access to safe water	8	2010	Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2012* (Lahore: Oxford University Press, 2012).
Without access to sanitation	52	2010	Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2012* (Lahore: Oxford University Press, 2012).
Malnourished children (Under 5)	31	2009	*Asia Pacific Human Development Report 2012* (UNDP, 2012).

This first chapter has tried to answer the difficult question of whether Pakistan—as a people and as a nation—is better off today than in 1947. There is no definite answer to this question. In many ways Pakistanis are far better off than they could have ever imagined; in other important areas, they have not even begun to address the issues that a country at the level of Pakistan's economic, social, and political maturity should have resolved (see Table 1.3 for Pakistan's 'indicators of failure'). Pakistan could have done far better than it has, as has been shown by the performance of other comparable countries. That it has not implies a certain level of failure. But then again, given constraints and initial endowments and material conditions, and the interactions of different social and political classes and groups, perhaps this was unlikely.

However, when we do compare Pakistan with countries in the region—Bangladesh and India, for example—the prospects for Pakistan increasingly look far worse than for these two countries. Perhaps Pakistan has been left behind, in terms of economic development now by India, as it was in the 1960s, by South Korea. With greater globalization where human capital and domestic conditions—democracy, peace, law and order—increasingly play a critical role in development, Pakistan's future prospects do not look promising. Moreover, one must be more objective in our analysis about making simplistic comparisons between military rule and civilian government in Pakistan, when we know that the latter has been restricted and manipulated by the former, as Chapters 26 and 27 emphasize. Just because growth rates under military rule have been higher than under civilian government, does not imply that military rule is 'better' or preferable to democratically elected governments. As the *Economist* recently reminded all those who have a penchant for supporting the military in Pakistan—and sadly there are too many who still continue to do so—'the regular intervention of soldiers in Pakistani politics has undermined civilian institutions, encouraged the growth of terrorist organizations, distorted spending priorities, and poisoned relations with India'.[7] While civilian governments have numerous failures to their credit, given the fact that it is far more powerful, one must hold the military far more responsible for destroying Pakistan's state, institutions, and society.

We have presented here a 'before and after' picture without giving the 'how, what, and where' of Pakistan's economic development. The rest of the book tries to complete picture, and seeks to understand and explain Pakistan's particular story. The answer to whether Pakistan after sixty-six years has been a success or failure is to be found in the chapters that follow.

Notes

1. Innovative Development Strategies (Pvt.), *Profiling Pakistan's Rural Economy for Microfinance (Islamabad:* Pakistan Microfinance Network, 2009).
2. Reza Ali's seminal unpublished work shows that perhaps 98 per cent of the Punjab lives within two hours of a city, and 82 per cent about one hour away. His assessments based on the 1988 Census, of fifteen years ago and when so much has changed, suggests that approximately 74 per cent of the Punjab was urban, Sindh 53 per cent, Khyber Pakhtunkhwa 45 per cent, and Balochistan, mainly Quetta, 12 per cent. Since 1998, urbanization has increased at a much faster pace.
3. Zaidi, S. Akbar, 'Contesting Notions of Pakistan', *Economic and Political Weekly*, vol. 47, no. 45, 2012.
4. The term 'lifestyle liberals' was first coined by Faisal Siddiqi.
5. See, Zaidi, S. Akbar, *Military, Civil Society and Democratization in Pakistan* (Lahore: Vanguard, 2012).
6. See Zaidi, S. Akbar, 'Resilience in Pakistan's Democracy? The Tahir-ul-Qadri Episode', *Economic and Political Weekly*, vol. 48, no. 5, 2013.
7. 'The general in the dock', *The Economist*, 29 June 2013.

2 Is Pakistan Feudal? A Historical Account of the Development of Agriculture in Pakistan

There is a general perception held by many within Pakistan that, even in the twenty-first century, Pakistan is a 'feudal' country. This view is endorsed by political scientists, observers and journalists, the electronic media, and lay people in general. It assumes that in the economic, political, and social arena, Pakistan and Pakistanis have 'feudal social relations' and are 'feudal in attitude'. The label 'feudal' is pasted on to anyone owning large tracts of agricultural land, and even on rich urban dwellers who seem to have no known or apparent source of income to support their ostentatious lifestyles. Essentially, the popular image from film and television is of a feudal as someone who lives in luxury, often, but not necessarily, having an agricultural background. Politicians, especially, are considered to be from feudal backgrounds, and even the more sensible magazines and newspapers endorse the impression that the national and provincial assemblies in Pakistan are predominantly full of 'feudals'.

This chapter, the first of four on the agricultural sector, will try to assess the claim that Pakistani agriculture, and hence Pakistan, is feudal. We will recount the history of agricultural development in Pakistan from the pre-colonial Mughal times and examine the consequences of British rule for the social and economic relations of production within agriculture. This narrative will summarize the changes that have taken place over three centuries and culminate with a picture of the agricultural sector at the time of independence in 1947. The next chapter will develop the story of agriculture in Pakistan, explaining how the process of the development of agriculture continued after Pakistan came into existence.

A recurrent underlying theme of this book is that one needs to examine the present as well as the past. In other words, we need to see the present as a part of the historical process from which it may have evolved, and to which it may be linked. To some readers it may seem a little irrelevant that in a book about economic issues in contemporary Pakistan we begin the first substantial chapter with a history that goes back four centuries. We have argued in the Introduction why this is the manner in which issues should be discussed, and that this is the pattern adopted in this book. In addition, the question of whether Pakistani agriculture is feudal or capitalist has important economic, social, and political ramifications. The nature of agriculture has important repercussions not only for agriculture, but also for numerous related and distant sectors within the economy. This point will become clearer as the narrative progresses, especially when we discuss the social, political, and economic consequences of the Green Revolution. Suffice it to say that it is important to observe how societies change, especially when they are transformed from one major historical epoch (or mode of production), feudalism, to another, capitalism (see Boxes 2.1 and 2.2). This chapter will do precisely that.

2.1 The Development of Agriculture before the Consolidation of British Rule

Some social scientists believe that pre-colonial India was a stagnant society with little progress taking place and rigid economic and social structures, and that it was only British rule which awakened the Indian subcontinent from its slumber. They believe that, had it not been for the positive and modern impact of British colonialism, most of South Asia would still be backward and perhaps still stuck in the nineteenth century. On the other hand, there are other social scientists who believe just the opposite. For them, the modernizing impact of British colonialism was debilitating and cruel, and they feel that the underdevelopment that we see in the South Asian subcontinent today is a result of that colonial impact. These are different ways of reading into, understanding, and interpreting history, and each individual has the privilege to reach his or her own conclusions. Here, we briefly present an outline of the nature of agricultural production before the conquest of India by the British.

India was a pre-capitalist social formation prior to the British conquest. There is some evidence of development and change in a society that was essentially pre-capitalist, and some writers have suggested that this movement was towards capitalism.[1, 2]

During the pre-British period, under the Mughal Emperor, all land was owned by the king alone. There was no private property in land, and permission for the use of land was granted by the king. In 1647, the ruling class comprised the Emperor and about 8,000 *mansabdars* or nobles who were supposed to maintain large armies to serve the Emperor whenever he so required of them. These *mansabdars* were either paid salaries in cash or, as was more common, were given *jagirs* or large tracts of territory in which they were responsible for collecting revenue from the peasants and then transferring it to the state. Such *jagirdars*, or revenue collectors, were transferred from one area assigned to them for the purposes of revenue collection to another, usually after three or four years, so that they did not have the opportunity to build entrenched bases for themselves. While *jagirdars* were essentially officials rather than feudal lords,

Part 1

Agriculture

Agriculture has been the mainstay of the Pakistan economy for many years, although in recent years, its importance has somewhat declined. From a contribution to gross domestic product of more than half in the 1940s, today it accounts for around only 21 per cent. The share of employment in agriculture has also fallen, from more than 65 per cent of the labour force in 1950 to about 45 per cent today. The two most common perceptions held by students and observers of the Pakistan economy are that Pakistan is mainly an agricultural country and that Pakistan's agriculture is 'feudal'. The four chapters on the agricultural sector in Pakistan deal with these two commonly held myths. In Chapter 2, an attempt is made to trace the history of the development of agriculture in Pakistan, questioning the claim that the mode of agricultural production in the country is still of a feudal nature, a perception which is repeated *ad nauseum* by numerous commentators, both local and foreign. Large landowning patterns are often confused with feudalism leading to misperceptions. Chapters 3 and 4 develop the theme of the transition of the agricultural sector, arguing that a more capitalistic and capital-intensive agriculture now dominates. Chapter 5 highlights the key issues that currently exist in the agricultural sector and, given the diminishing contribution of agriculture to the overall economy, suggests that perhaps Pakistan's economy is no longer mainly agricultural nor 'feudal'. Moreover, as has been argued in the Introduction and in Chapter 1, with the 'urban' set to define Pakistan more markedly, along with the rise of a vocal middle class, issues related to the agricultural sector will need to be redefined. Nevertheless, one cannot dismiss the agricultural sector completely, especially since interventions by the government between 2008 and 2013 continue to have major consequences.

Box 2.1

What are Modes of Production?

Doug McEachern writes:

For our purposes, it is sufficient to recognize that the term 'mode of production' refers to those relations that exist at the heart of a given society, identify the major classes of that society and indicate the inherent logic of the relations and conflicts between those classes. In all societies we may identify means of production, direct producers and a relevant class of non-producers that combine in a process of social production. Production is also surplus production and surplus extraction; that is, the process of production also constitutes a process of class exploitation. The relations generated in the production process assume a different character in societies dominated by different modes of production. The problem is to suggest the different character of these relevant direct producers and non-producers and the forms of the relationships between them.

The modes of production identified by Marx can be codified as follows: *Primitive Communism* is a mode of production in which the means of production (low level methods of hunting and agriculture) are dominated by some form of communal institutions which organize production and distribute the surplus. *Feudalism* is a mode of production in which there is a partial separation of the direct producers from the means of production (largely the basis of agricultural production, land and the means to work that land). *Capitalism* is a form of society in which the direct producers have been separated from the means of production. These now exist as the private property of a class of non-producers. These outlines do not indicate all the ingredients of the modes of production. It is also necessary to show the way in which the various classes relate to each other through their relations to the means of production in the processes of production and surplus extraction. In primitive communism the problem is less obvious. Through membership of the community one has access to the means of production and the production process. On that basis, means of survival are acquired. Under feudalism, the situation of divided ownership, but with a dominant position (especially over the ownership of land) going to the non-producers, production and surplus extraction is organized through rent and tax relations. (It is incorrect to see a division between the process of surplus extraction and the domination of the means of production. The direct producers do not control the production process and the surplus is not extracted by external, essentially non-economic relations). Under capitalism, the form of association is through wage-labour and surplus is extracted through surplus value relations and based on the separation of the direct producer from the means of production. Further, each mode of production has a characteristic state form. Primitive communism is a society without classes and without a state as such, although state-like functions are performed by other means. In feudalism the state and the process of surplus extraction are closely interconnected; the state is involved both at a national level and in the local process of production and accumulation. Under capitalism, the state is formally separated from the economy, centralized, bureaucratic and concerned with relating (mediating?) the relations between the economic and political spheres of society. Although different state forms appear to coincide with different modes of production, it is open to dispute whether the form of state is part of what constitutes a mode of production.

Source: McEachern, Doug, 'Capitalism and Colonial Production: An Introduction', in Alavi, Hamza et al. *Capitalism and Colonial Production* (London: Croom Helm, 1982), 5–6.

another category of assignees, the *zamindars*, bore a closer resemblance to the concept of feudal lord. *Zamindars* were also responsible for collecting revenue on behalf of the king, and were usually amongst the influential individuals from the villages. The Mughals had established a strong and elaborate revenue system under Akbar in the 1570s. Besides these two mechanisms for collecting revenue, there were also *khalisa* lands, from which land revenue accrued to the state directly.

The *zamindar* was the local lord and (feudal) master and had an obligation to the state to collect revenue and turn it over to the Emperor. Although he did not own the land, in many ways he had the characteristics of a feudal lord (see Box 2.2). He was the supreme lord at the village level, the 'linchpin of the system'. He used coercive force and extra-legal methods to extract revenue. He also presided over all social and judicial matters at the village level. Although he was appointed by the Emperor, he exercised complete authority at the village level. Here, there was a fusion of economic and political power at the point of production.

Under the Mughals, as all land was owned by the king, there was no question of land being inherited by either the peasant's family or the *zamindar*'s. There were no occupancy rights that could be alienated or mortgaged, although some transfer within villages or families did take place. While *zamindars* and *jagirdars* were in a position to assert authority over assigned tracts of land, their position was dependent on the favour of the ruler. In many cases, the right to collect revenue after the death of a *zamindar* was passed on to his sons, but this too depended on how much the Emperor wished to retain the status quo.

Soon after the death of Aurangzeb in 1707, the Mughal empire began to decay and fall apart. As central authority weakened, there were contending claimants to power. The *zamindars* and *jagirdars* who were the intermediaries in the Mughal system became more entrenched where they could, and tried to strengthen their claims on the land and increase their hold on the peasants.

Box 2.2

What is Feudalism?

Most people, when they use the terms 'feudal' and 'feudalism', do so rather loosely. They forget, or do not know, that 'feudalism' is an economic concept and that, when we talk about feudal relations, we usually mean relations, whether social or economic, based on a number of economic criteria. There has been continuous debate about what exactly feudalism entails. A number of historians and scholars have examined the conditions mainly in Europe before the Industrial Revolution, and have identified certain economic features that define feudalism. We present below a list of components or properties of the feudal mode of production which gives us some flavour of what the concept of feudalism entails. Feudalism is a concept that relates specifically to the agricultural sector. Hamza Alavi has explained the five criteria that constitute feudalism as follows:

i) *Unfree labour* rendered not necessarily in the form of labour services but taking a variety of possible forms. That would be contrasted with free labour in CMP [capitalist mode of production], in a double sense (a) in that it has been separated from (or 'freed') from possession of means of production (land) and (b) that it is free from feudal obligations to serve a lord; the direct producer is now free to sell his labour power or starve.

ii) *Extra-economic coercion in the extraction of the surplus* from the direct producer, as against economic coercion as the basis of exploitation in CMP.

iii) *A fusion of economic and political power at the point of production and a localized structure of power*, as against separation of economic (class) power and political (state) power within the framework of a bourgeois state in CMP. The power of the exploiting class, the bourgeoisie, over the exploited class is then exercised indirectly, through the state apparatus and subject to the rule of (bourgeois) law, and not exercised arbitrarily and directly as in FMP [feudal mode of production].

iv) *Self-sufficient ('subsistence') economy* of the village (or the manor), commodity production being secondary for the direct producer; subject to the condition that he produces also a surplus that is appropriated by the exploiting class of which a significant proportion may enter into circulation as commodities. That contrasts with generalized commodity production in CMP where (a) production is primarily of commodities, i.e. to be sold for the value to be realized on the market and (b) labour power itself is a commodity.

v) *Simple reproduction* where the surplus is largely consumed by the exploiting class which acquires it, instead of being accumulated, so that the economy and society merely reproduce themselves on the existing level of productive resources and technology, whereas in CMP we have expanded reproduction of capital, where the surplus is primarily deployed towards capital accumulation (although not without supporting rising consumption levels of the exploiting classes) and consequent expansion of the forces of production and technological advance.

Source: Alavi, Hamza, 'India: Transition to Colonial Capitalism', in Alavi, Hamza et al. *Capitalism and Colonial Production* (London: Croom Helm, 1982), 29.

Two other explanations of feudalism are also given below:

a) D. N. Jha argues:

The word 'feudal' or 'feudalism', often traced to the *feos* occurring in Burgundian charters from about 881, came into a general use during the Enlightenment and the French Revolution when it stood for what appeared to be a body of irrelevant and obnoxious practices inherited from the *ancien regime*. It was, again, during this period that there took place a certain bifurcation in the meaning and uses of the word 'feudal' or 'feudalism'—a bifurcation which has persisted to this day and has influenced historical writings and to which attention has been pointedly drawn by David Herlihy (*The History of Feudalism*, New York, 1970, xiii-xxi). Some historians have thus viewed feudalism as an agglomeration of institutions connected with the support and service of knights and as a system of law, government and of military organization, whose central feature would appear to be administrative decentralization. Indian historians have sometimes been influenced by this concept of feudalism and they have often used feudal terms to describe a situation of parcelized sovereignty. . . .

As against the concept of feudalism as a system of government, the school of Marxist historians has equated the feudal phenomenon with a mode of production based on 'feudal rent' which subsumes the existence of a class of landlords (landed intermediaries), a basic class of producers (peasants) with a special connection with the land which, however, remains the property of the former, and of the overwhelmingly self-sufficient agrarian economy with little scope for the functioning of a market system. The study of feudalism within this frame of reference focuses attention on serfdom and various other forms of constraints on peasant freedom. In India these aspects of feudalism have attracted the attention of historians like D. D. Kosambi, R. S. Sharma and B. N. S. Yadava who, however, have not remained uninfluenced by non-Marxist scholarship. Kosambi, for example, speaks of 'feudalism from above' as being the first stage in the development of feudalism in India—a stage which corresponds to the orthodox view of the phenomenon as a system of government. Sharma and Yadava emphasize serfdom and immobility, subjection, economic bondage and unfreedom of the peasantry, and yet both devote considerable space to feudalism as a system of government.

Source: Jha, D. N., *The Feudal Order: State, Society, and Ideology in Early Medieval India* (New Delhi: Manohar, 2000), 36.

Box 2.2 (Continued)

What is Feudalism?

b) A Chinese historian shows what feudalism meant in medieval China:

The feudal system is founded upon agriculture and handicrafts conducted within the boundaries of the local community (*difang gongtongti*). A single village or a number of villages constituted the local community which possessed in common forest and pasture land, water resources and arable land. In this local community the common land and the fields which were distributed among the peasant households provided the necessities of life; for instance, the fields, hunting and fishing, and domestic animals (provided the necessities for consumption) while materials such as timber and sheep wool provided the raw materials for household industries. This kind of local community was ordinarily *a self-sufficient economic organizm and had little economic interchange with the outside world*. The local lord nurtured within the community awe for his powers. The king was only an elevated lord and did not have the power to subject other lords to his will; hence the feudal state had an extremely loose organization.

Source: Mukhia, Harbans, 'Was there Feudalism in Indian History?', in Mukhia, Harbans, *The Feudalism Debate* (New Delhi: Manohar, 1999), 155.

2.2 The Impact of British Colonialism

> With the start of active colonial expansion in South Asia in the middle of the eighteenth century, the British established either direct or indirect control over the greater part of its territory by the end of the century. Spreading the sphere of their political influence in the direction from the east (out of Bengal) towards south-west and north-west, they stopped in the case of the latter direction at the lines that closely fit the present-day frontier between India and Pakistan. The north part of these lines coincided with the confines of the Punjabi Kingdom, and the south one with the boundary of Sindh with the authority of feudal rulers from a Baluchi clan of Talpurs to be established there by that time. A distinctive feature of the north-west regions was predominance of Moslem population.[3]

There is little disagreement among social scientists about the proposition that profound changes were brought about in the character of Indian society following the imposition of British rule. For our immediate context, three institutional changes introduced by the British had important consequences for landholding and agricultural production. The institution of private property, as the British understood it, was introduced in India in the late eighteenth and early nineteenth centuries. At the same time, a legal system was established that was closely related to the ownership of property. And thirdly, the British established an 'efficient government'.[4]

Hamza Alavi analyses the impact of these changes and says:

> The main impact of the change brought about by the colonial dispensation was the elimination of petty sovereignties of chieftains and *zamindars* who *ruled* the land, as much as they owned it. *Thus the 'fusion of economic and political power at the point of production', that we identified as a structural condition of feudalism, the power of the landlord over the peasant, was dissolved and was reconstituted in the form of bourgeois landed property, under the authority of the colonial state which marked a separation of economic and political power*. The most important turning point in the evolution of new system of landownership brought about by the colonial regime was the 'Permanent Settlement' in Bengal (of land revenue obligations) of 1793 which was instituted in conjunction with fundamental changes in the rural social and economic structure. The peasant was dispossessed of the land which now became the 'property' of the zamindar. Concomitantly the direct coercive powers of the zamindar (and his private armies) were abolished.[5]

The multiple claims that had emerged following the decline of the Mughal empire were 'systematized and unified' under the British all over India. The Permanent Settlement in Bengal in 1793 conferred property rights in land on the revenue collectors who were found as intermediaries between the cultivator and ruler. With the decline of Mughal rule, zamindars took over *de facto* possession of land. 'The British in their first settlements then granted to this zamindar a property right that in their judgement would be stable and ensure the collection of their revenue demand through him.'[6] Essentially, then, we have the beginnings of the concept of private ownership of land and of private property, protected by a legal system that recognizes these property rights.

This imposition of the legal concept of private property and ownership of land was a major step forward in transforming the indigenous society in the direction of a bourgeois, capitalist society. The British introduced the institution of the alienation of property in land by virtue of bourgeois civil law proceedings. With this, the principles of inheritance, guaranteed rights, and the privilege of succession were implemented.

Sindh was annexed to the British empire in 1843. The British 'made their first settlements on the basis that land was held directly from the state on a tenancy basis but its security was guaranteed. Payment of land revenue was a condition for the usufruct of land. The occupant was given heritable and

transferable rights of occupancy. The land system was called the *ryotwari* system in which the state was the landlord and the occupant was its ryot or tenant.'[7] At the other end of the spectrum, the British granted ownership rights on large tracts of land to the Mirs as *jagir* lands. Other influentials were also awarded similar grants, so long as they provided services of some sort to the new rulers of India. These owners of large tracts of land became the landlords of Sindh.

Apart from these important changes in the relationship between land and the intermediary or owner, the British were responsible for numerous other changes which resulted in agriculture developing on capitalist lines. The introduction of the monetary tax, and the fact that it had to be paid regularly and on strict terms, required producers to sell their crops in the market to pay the tax on land. A market for agricultural commodities emerged, and the previous self-sufficiency and remoteness of villages was shattered. A much greater integration of the rural economy with that of the rest of the Indian subcontinent—and, subsequently, with the economy of imperial Britain—followed, with desolate and far-flung places becoming part of the money and commodity exchange nexus.

These interventions in the agricultural economy caused the cropped area and the marketable agricultural produce to grow. No cotton was grown in Sindh at the time of the British conquest. However, in 1873–4, 4,000 tons were produced, while Punjab's production grew over seven-fold in less than ten years from the mid-1850s to the mid-1860s.[8] Thirty times more wheat was exported from the Punjab in the 1880s than in the 1860s. As the industrial revolution progressed in Great Britain, there was a dire need for raw materials. In the 1840s and 1850s a poor cotton crop in North America produced a shortage of raw cotton for industry in England. It was at this time that British industrial capital urged the imperial government to develop resources to extract further raw material from India. With increased production for the market, the local economy became more integrated with, and dependent upon, the requirements of imperial Britain.

As the commercialization of agriculture continued and as the tax burden began to be felt, many landowning peasants were unable to pay the taxes and had to seek loans from money-lenders and merchants. Some were even forced to sell or mortgage their lands. Zamindars and *jagirdars* were expected to pay taxes on fallow land as well as on cultivated land. As some of them were unable to pay the tax, they were forced to sell their lands. The land of the defaulters was bought up by usurers, tradesmen, and merchants, many of whom belonged to urban areas with little direct involvement in agricultural production.

While these tax laws were strictly enforced, they began to have serious negative repercussions as far as the British were concerned. The colonial authorities felt that the landed aristocracy was the mainstay of their power in Sindh and the Punjab, and the erosion of their economic and, hence, political power was undermining the political strategy of the British. Thus, in Sindh between 1870 and 1890, a series of acts and laws were passed to protect the rights of the zamindars. Earlier, from the mid-1860s in both the Punjab and Sindh, courts of civil justice had come into existence which ensured the compulsory alienation of land in the case of non-payment of debt. The 1870s saw the beginning of the replacement of the initial land taxation code with a revised version under which only cultivated areas were subject to taxation and there was no tax on fallow lands. However, despite this change, in the mid-1890s over 42 per cent of usable land in Sindh either had been appropriated by, or was in the possession of, usurers under mortgages.[9] In the Punjab, the British went one step further. They were quite disturbed about the fact that, due to a debt market emerging and with landlords unable to pay their taxes and loans, agricultural land was going to non-agricultural users. They felt that this would undermine the position of the 'agrarian castes' on whom the British relied. Thus, they implemented the 1900 Punjab Land Alienation Act, which prohibited the passing of land from agricultural to non-agricultural castes and permitted land transfers only within the related agricultural caste group in each district.[10]

From 1885 onwards, the economy of the Punjab began to be reshaped by the considerable extension in agricultural production which resulted from canal colonization after the late 1870s. While the process of building canals took place all over India, the coverage in the Punjab was particularly impressive.[11] In the early years of the twentieth century, a little over half of the entire irrigated area was watered from canals. Within a period of two decades, canals watered about 80 per cent of irrigated land. In the first half of the twentieth century, the rate of expansion in the area of irrigated lands in the territory that now constitutes Pakistan outstripped the Indian region. The area irrigated from water from state-owned canals in the Pakistani territory saw an almost seven-fold increase in the first half of the twentieth century.[12]

The British needed to expand the potential area of agricultural production in India so as to ensure the availability of raw materials for industry in Britain, and for food crops in the Indian subcontinent, where the population was increasing at an alarming rate and the threat of famine loomed large. While early British policy had broken the century-old shackles of rural Indian life, capitalist agriculture was only just emerging. Hence, to increase production, rather than use intensive means, a more expansive form was necessary to bring more land under cultivation. The canal colonization programme was the result of this policy. The British did not want to settle rentiers on the newly colonized lands, and instead were looking for small well-to-do agriculturalists of the yeoman type, who would cultivate their own holdings. Grants were given to peasants to cultivate land, the ownership of which the state had every intention of retaining. These peasant grantees were to remain as occupancy tenants of the state and were not allowed proprietary rights. However, this policy was changed when this landholding peasantry, essentially of the self-cultivator type, was given proprietary rights in 1912.

According to some scholars, the principal change to take place in the first half of the twentieth century in the rural areas of Sindh and the Punjab was the increase in landlordism, which occurred by increasing the number of landlords and the landlord ownership of land.[13] In the Punjab, land ownership became increasingly concentrated,

with large landowners controlling 38 per cent of arable land by 1939 (see Table 2.1). In 1947 in the Punjab, the owner-cultivated arable land comprised about 42 per cent of the total, while the remaining 58 per cent was leased. In Sindh, 80 per cent of the land belonged to big and middle owners of the more traditional landlord type, and was let out to lease. In the Punjab, 51 per cent of the sown area was cultivated on conditions of non-occupancy tenancy. This percentage was much higher in Sindh, where landlord ownership and peasant land-use constituted the most typical pattern of the region.[14]

In Sindh and the Punjab, tillers of land were usually called *muzareen* or *haris*, whose rights to cultivate land under the British were not recognized in law or practice. In the Punjab, some tenants, *maurusi muzareen* (occupancy tenants), did have the law on their side regarding a hereditary right to cultivate land, but such rights were not always respected in practice. In Sindh, while the Mirs were granted *jagirs*, the British had also recognized the rights of tenants who held land owned by the state, and their security was guaranteed as long as land revenue was paid to the state. The occupants of these state lands had heritable and transferable rights of occupancy. This was the *ryotwari* system, where the tenant, ryot, worked on the land of which the state was the landlord (see Figure 2.1).

The zamindar and the *jagirdar* parcelled out land to the *haris* and *muzareen* in lots of 10–15 acres. A manager or *kamdar* used to oversee the work of the tenants. The *hari* was a landless sharecropper 'who traded his family's labour for a share in output which in theory was fifty per cent of the gross produce. He also supplied seeds, implements, and oxen. In addition to the *batai* share, a *hari* paid levies and perquisites, and provided free labour to the landlord. The landlord paid about one-third of his net rental share to the state as land revenue. He usually assigned to a *hari* each year a different block of land to prevent the *hari* from establishing any occupancy rights on a particular piece of land'.[15]

Table 2.1
Structure of Land Ownership in the Punjab Province: 1924 and 1939 (%)

Plots, acres	1924		1939	
	Owners	Area owned	Owners	Area owned
Up to 5	58.3	11.2	63.7	12.2
5–10	18.0	15.1	16.9	13.1
10–15	8.6	12.5	7.3	9.1
15–20	4.3	8.4	3.6	7.2
20–25	2.7	6.8	2.2	5.6
25–50	4.8	20.4	3.9	14.8
Over 50	3.3	25.7	2.4	38.0

Source: Belokrenitsky, Vyacheslav, *Capitalism in Pakistan: A History of Socioeconomic Development* (New Delhi: Patriot Publishers, 1991), 99.

2.3 Feudal or Capitalist?

In the previous two sections, an attempt has been made to delineate the main features of the agricultural sector from the period of the Mughals to about the time of the independence of Pakistan. The direction of the discussion has been towards examining the issue of whether Pakistan's agriculture is, or was, feudal or capitalist. To do this, we need to show how the development of agriculture has matured from one historical form to another. If we reach the conclusion that

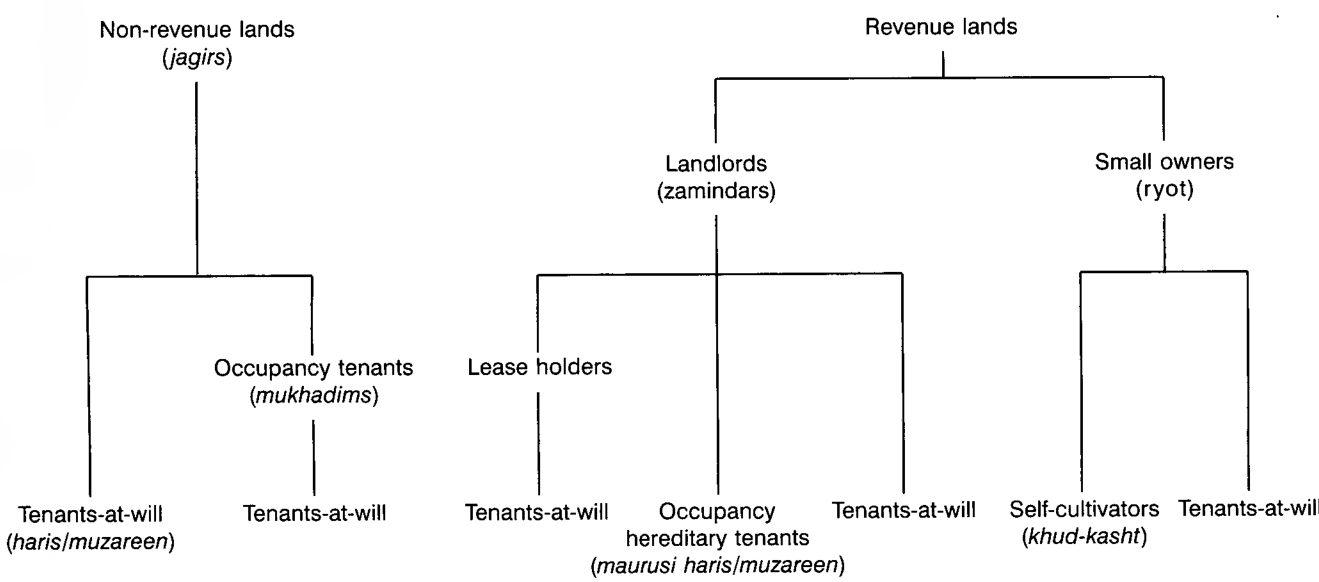

Figure 2.1
The Land Tenure System in Pakistan (circa 1947)
Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder: Westview Press, Colorado; 1981), 131.

until 1947 Pakistan's economy, particularly the dominant agricultural economy, was still overwhelmingly pre-capitalist, and that capitalist forms of agriculture had not established themselves, then Chapter 3, which examines the post-independence era, will need to evaluate the nature of this transition from one mode of production to another. On the other hand, if we conclude that the transition from feudalism to capitalism took place many decades ago, then we can take up the theme of the development of capitalism in agriculture in Pakistan since at least the early years of the twentieth century. This discussion is important because there are still many observers and students of Pakistan's economy who feel that Pakistan in general and its agriculture in particular are 'feudal'. Let us interpret the evidence.

There is a great debate over the claim that British colonialism initiated capitalism in agriculture in the regions that constitute Pakistan. Imran Ali, who examines the impact of the British on the Punjab, especially with reference to the canal colonies of the province, writes that there was an absence of an agricultural revolution in the region. He accepts the fact that there 'was great economic growth' in the canal colonies, but 'agriculture did not experience any major transition from traditional modes. Quantitative increase was not accompanied by qualitative change.'[16] He argues that, if we look at conventional growth indices such as cultivated area, output, marketing, and trade, we see an 'impressive process of growth'. He adds that the process of agricultural colonization transformed the Punjab 'into one of the most important areas of commercial farming in Asia',[17] with agricultural produce being exported all over the world. Imran Ali also discusses the impact of the extended communications network, especially railways, on increasing agricultural production, and how the monetization of the rural economy was responsible for the greater integration of the backward areas with the rest of the world. However, he concludes that 'capitalistic forms of agriculture . . . did not emerge on any significant scale',[18] and that 'agricultural expansion did not produce a social base conducive to rapid change; indeed, the reinforcement of the existing class structure created, through the very process of economic growth, *a situation that was hostile to an economic transformation*'.[19]

So, for Imran Ali, the conclusion is clear: agriculture remained feudal or at least pre-capitalist under the British and, if anything, the old structures were *strengthened and reinforced* by colonial intervention. This interpretation, which is difficult to accept, is drawn into question by much of what Imran Ali himself describes. For example, he recognizes that 'the process of individualization [of property rights] created, probably for the first time, the prospect of alienation of land rights. With the increase in marketing of agricultural produce, aided by the development of road and rail transport, land came to have a monetary value',[20] and 'after 1880 there was a considerable increase in land sales in the Punjab . . . Agriculturalists entered more into the money economy. . .'.[21] Mahmood Hasan Khan, the great doyen of agricultural economists in Pakistan, shares views somewhat similar to Imran Ali's, writing as follows:

> With the recognition of absentee landlordism, and its protection by the British in the Indus basin as in other parts of India, *there emerged an agrarian system which could not have led to economic development*. The fusion of the feudal rural society and British administration decisively eliminated the chances for positive change in India. The economic surplus which peasants created was appropriated by those in the society who failed to invest in industrial growth. The relative abundance of land was fast disappearing and the peasant population was rising at unprecedented rates, with their consequent adverse effects on prospects of growth and on the condition of peasants. The problem of underdevelopment was intensified further by the growing imbalance between land and population. The British settlements gave birth to an economic and political system which could not get the Indian society in general and peasantry in particular out of the morass of backwardness. *This system reinforced feudal relations on land* which, though asymmetrical, provided a measure of stability for the colonial power to rule India.[22]

Let us now come to a different interpretation, where scholars believe that the colonial influence actually generated and speeded up the process of change in agriculture, from feudalism to capitalism. While there is some debate about the existence of capitalism and capitalist tendencies before the arrival of the British, many scholars believe that the impact of the British was both to destroy and to create.[23]

A critical element that would differentiate capitalist from pre-capitalist forms is the pattern of ownership. We have seen that in pre-colonial times land was owned by the supreme ruler of India, and that after the collapse of the Mughals contending claims surfaced, with ownership being determined by land-grabbing tactics. The British instituted the capitalist and bourgeois concept of private ownership of land, making it marketable and alienable, and introduced a legal system to protect owners and the market, guaranteeing the protection of bourgeois property and personal rights. We would argue that this step was such a radical and progressive departure from past practice that it alone would be responsible for the emergence and growth of capitalist, not feudal, development. Furthermore, the emergence of a land market in the 1860s; the imposition of a land tax which was in cash not in kind, as were other taxes; the establishment of official sources of credit, even long-term credit; the hugely expanded quantity of crops grown, much of them being exported, with cash crops taking an increasing share in production; the increasing polarization between landlords and the growing landless, with wage labour emerging; greater interaction and integration between town and country, breaking away from the self-sufficiency and isolation of the village community; and the advent of small-scale manufacturing, set up near agricultural zones to produce implements that could improve and expand agricultural output—*all point to a conclusive shift from a pre-capitalist to a capitalist type of agriculture*. Importantly, too there was a marked shift away from the fusion of economic and political power at the point of production, which was so

central to feudal power relations, once bourgeois British law and political control over the Indian subcontinent was concretized.

In fact, Vyacheslov Belokrenitsky identifies approximate dates for specific events, highlighting the point that the roots of capitalism had been laid during the time of the British. For example, he points out that a land market had emerged during 1860–70 (29); in the early 1860s, land tax was in cash rather than in kind (42); in the mid-1860s, courts of civil justice came into existence, overseeing the compulsory alienation of land in the case of non-payment of debt (44), and this could have happened only after private property in land had been established; after the 1880s, in Punjab and other areas, the export specialization of agricultural commodities took place, i.e. the agricultural economies joined the world and national capitalist markets, producing for exchange and profit (108); and the first half of the twentieth century saw an increase in the number and share of landless agricultural labour in the countryside, especially in the Punjab, and a key feature of the capitalist form of economy in agriculture, the free worker, emerged and was a fact of life (105).[24] All these factors cast doubt on the claim that feudalism continued to exist well after the establishment of British colonial rule.

A number of scholars recognize the fact that the British colonial influence affected the genesis of capitalism by creating a somewhat 'distinctive form of capitalism', and that the transformation of these non-capitalist societies took place by the domination of capitalism through a process of colonial rule.[25] Belokrenitsky, for example, argues that when in the nineteenth century British rule was established in the regions that became Pakistan, it did not distort the evolution of capitalist relations there, for the latter had not started taking shape by that time. Capitalism that came into existence in that part of the world, under the direct and indirect impact of colonial conditions, was initially a kind of by-product of the policy pursued in India by colonial authorities, and of the influence they produced in direct and indirect ways on the local society.[26]

Moreover, Belokrenitsky argues that the 'development of capitalism as such (or rather of a western economic system familiar to the English) was not directly perceived as a goal of the colonial rule . . . although it was stressed that the coming into existence of components of these practices would be desirable'.[27]

In dealing with the sort of conclusions reached by Imran Ali, discussed earlier, Doug McEachern argues that some researchers have assumed that if the surplus was extracted from the agrarian sector and not reinvested in technology and improved production in agriculture, then the mode of production would not be capitalist. He argues that this surplus can be accumulated in other spheres or even in other countries, as was the case in India, where surplus was transferred to Britain.[28] Moreover, he says that widespread commodity production and the sale of goods for the market (a fact observed in India even by Imran Ali) are 'incompatible with the designation of feudal or unchanged class and production relations . . . such an occurrence is only possible on the basis of a reorganization of production and the generation of a new set of class relations'.[29] McEachern concludes that colonial domination and economic policy initiated the process of capitalist development in agriculture in India. Hamza Alavi elaborates on these themes in great detail and is also clear in his conclusions, arguing that a particular type of capitalism, one tainted by colonial rule, was observed to be emerging all over India. Without question, pre-capitalist forms of production were being replaced by capitalist forms under British colonialism. He argues that:

> what we have in colonized India, therefore, is a capitalist mode of production, *but a capitalist mode of production that has a specifically colonial structure.* One thing is clear. *The feudal mode of production was dissolved* and there is no basis on which we can justify designation of relations of production in agriculture that resulted from the colonial transformation, any more as feudal.[30]

We conclude our analysis that capitalism in agriculture was observed to have emerged in the areas that constitute Pakistan as early as one hundred years ago. The seeds had been planted by British colonization in the early nineteenth century and bore fruit in the early twentieth century. Clearly, huge tracts of pre-capitalist or feudal landholdings, especially in Sindh, continued to exist. But the trend and process was *one conclusively of moving away from feudalism and dissolving pre-capitalist forms of production, replacing them with capitalist forms*. Hence, while feudal practices may have been extensive at the time of independence, and, in fact, may have even been dominant (see Table 2.2 and Appendix 2.1), capitalist agriculture has been the leading trend and it is not possible to label Pakistan or Pakistani agriculture today as 'feudal'. As Appendix 2.2 shows, the myth of feudalism still prevails. However, our interpretation of the facts leads us to believe that, once the transition began and became more entrenched, capitalism soon asserted itself, removing pre-capitalist forms of production, albeit some continue to remain. The next two chapters develop this theme further.

2.4 Popular Perceptions of Feudalism

In the 1980s, there used to be a television serial which became immensely popular called *Waris*, which was based on the life and times of a *choudhry* and his family in the Punjab. The main character was a 'feudal' and the storyline followed the changes that were taking place in his village, how new, modern and urban values and culture were replacing the outmoded earlier values of 'feudalism'. The serial was an excellent articulation of the contradiction which was emerging then between the old world and the new. In the serial, the new world triumphed and the feudal lord was enveloped in flames which led to his death, and presumably, of the old order as well.[31]

For many people in Pakistan even today, the popular perception is that 'feudalism' in the guise of the *choudhry* and *vadera*, still exist, and that Pakistan continues to be 'feudal'. While television serials have moved with the times—perhaps too far ahead of the times—in showing themes which are

Table 2.2
Distribution of Land Ownership in Pakistan and Provinces: 1950–1955

Farm size (acres)	Pakistan		Punjab		Sindh	
	Number of owners	Area owned (acres)	Number of owners	Area owned (acres)	Number of owners	Area owned (acres)
All sizes	5,068,376 (100.0)	48,642,530 (100.0)	3,555,457 (100.0)	28,309,744 (100.0)	337,665 (100.0)	10,285,021 (100.0)
5 or less	3,266,137 (64.4)	7,425,614 (15.3)	2,358,119 (66.3)	4,438,517 (15.7)	100,601 (29.8)	365,817 (3.6)
5–25	1,452,421 (28.7)	15,438,138 (31.7)	1,029,108 (28.9)	11,041,708 (39.0)	155,163 (46.0)	1,937,073 (18.8)
25–100	286,470 (5.7)	10,616,308 (21.8)	146,893 (4.1)	6,198,128 (21.9)	54,792 (16.2)	2,390,358 (23.2)
100–500	57,287 (1.1)	7,671,537 (15.8)	19,401 (0.6)	3,842,986 (13.6)	24,064 (7.1)	2,600,123 (25.3)
500 and above	6,061 (0.1)	7,490,933 (15.4)	1,936 (0.1)	2,788,405 (9.9)	3,045 (0.9)	2,991,650 (29.1)

Note: The data for the Punjab are for 1954/5; for Sindh for 1946/7. The data for Pakistan are the aggregate figures for all provinces. The Punjab includes the former State of Bahawalpur, and Sindh includes the former State of Khairpur.

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder: Westview Press, Colorado; 1981), 68.

now predominantly urban and even global, the image of feudalism still persists. Because there is this popular *perception* of feudalism, it becomes even more important to dispel this myth and try to explain why this perception is wrong.

Most people are not concerned with the economic arguments which show that feudalism does not exist in Pakistan today, and they might even be convinced of these economic arguments if they spent some time understanding them. Many of those who even do agree with these *economic* and *structural* arguments turn around and say that there is a feudal 'mindset' in Pakistan and people have feudal 'attitudes'. This mindset and these attitudes are manifest in the following ways: people argue that most Pakistanis are disrespectful of rules, regulations, and laws and flaunt them openly; they misuse their positions of authority and misuse power whenever they get the opportunity; public servants are masters, rather than paid employees of the state, dependent on tax payers' money; women are mistreated, harassed, attacked, and not treated as equals to men; Pakistani society has a *darbar* culture, where ostentatiousness is the norm and privilege is misused and flaunted; patronage from those in power is the norm; corruption, from the *thana* and *kutchery* level to the highest public office in the country, is a standard and even accepted practice; there is a serious law and order problem at the local level caused by propertied and influential people who have their own private jails; there are large landholders and 'traditional' land owning families; nepotism (or bribes), rather than merit, determine access to the public sector employment market; people are supposed to be irrational, and hold outmoded 'unscientific', beliefs; . . . the list is endless. Without a doubt, every single one of these practices is pervasive in Pakistan. Yet, the key question is: Are these manifestations of feudalism?

First of all, let us reiterate what feudalism is and what it is not. Feudalism is primarily an economic system (mode of production, social formation), where the agricultural economy dominates completely; where there is little urbanization; where each unit (village, community) consumes much of what it produces, with little exchange between other settlements and areas. By this definition, Pakistan is clearly not a feudal economy. Also, the size of land ownership does not determine feudalism: farmers, or now increasingly corporate firms, own tens of thousands of acres in numerous countries, but no one calls these owners 'feudals', for the farms are run on the most sophisticated and advanced capitalist lines. So, first of all, the ownership size is not relevant to the feudalism argument. Also, there is a clear distinction between land *owners* and land *lords*, the latter being closer to the feudal model.

Moreover, even if there are *vaderas* and *haris* or *sardars* in some remote villages of Sindh and Balochistan, as indeed there are, and even if they are in an exploitative relationship which fulfils some of the criteria of 'feudalism', this does not mean that 'Pakistan is a feudal country' even though it may have some of these remnants or pockets of feudalism. For an economic system or a country to be 'feudal', the production relations which are specific to feudalism will need to be dominant, pervasive, across most if not all, parts of the country, and only then could one concede that the social and economic system could be called 'feudalism'. As we argue in Part I of this book, this is certainly not the case.

Many people who claim that there is feudalism in Pakistan, argue that there is a lot of 'exploitation' of the poor largely by landlords and landowners in the rural areas and that the poor, often landless sharecroppers and labourers, are treated severely. There is no denying that this is the case in many parts of Pakistan, but exploitation, even brutal exploitation, continues to exist in economies and societies which no

one would consider feudal. The peasants in much of Latin America, for example, have had to suffer oppression for many decades by the military, by landowners, and even by multinational corporations. Exploitation exists in all societies and is not necessarily a trait of feudalism alone. The fact that in Pakistan the law and order and justice situation is so miserable, where the poor (and the not-so-poor as well), whether rural or urban, have recourse neither to justice nor to protection, cannot be reduced to feudalism, for these are characteristics of numerous underdeveloped (as well as highly developed) capitalist societies having no history of anything akin to feudalism. These are manifestations of all class societies with varying degrees of scale.

Although nepotism and the lack of merit and excessive corruption are serious issues in Pakistan, this too is not necessarily a manifestation of feudalism alone. All societies have their version of the Old Boys Club of Oxbridge or Harvard and Princeton, allowing special privileges, unequal access, and benefits which accrue on the basis not of merit alone. Of course these are more abundant in underdeveloped societies, where kin, tribe, *biradari* also matter, but are fairly common in all societies, including the Japanese, American, and British. One allegation that people make in Pakistan is that families rule and dominate institutions, particularly in politics. This is common practice in most underdeveloped countries, particularly in South Asia, where there has been a family hold in the past, but even today, is still not uncommon in the West: the Kennedys, now the Bush family, perhaps in a few years Hilary Clinton as US President. While in the developed societies merit matters far more than connections and lineage, one cannot put everything down to merit alone; cronyism is not a characteristic of poor, underdeveloped, feudal societies alone. The choices of Pakistani voters also show that they do not necessarily vote simply on *biradari* or kinship lines and are far more astute than the credit given to them. Andrew Wilder, in a very interesting book, analysed the way voters elected their candidates in the Punjab, and found that they actually made sensible and rational, perhaps opportunistic, choices, rather than simply vote for someone on the basis of a relationship.[32]

Often vested interests or lobbies or mafias or *qabza* groups, are misconceived as 'feudal' interests. There are lobbies and vested interest in all societies, in some cases they are sophisticated, and in others rather crude and under developed, like their societies. Musclemen or mafias or cartels exist in the most advanced of societies, but only in Pakistan would they be seen as expressions of 'feudalism'. In fact many of these interest groups are a response to modern politics and the way the state functions and fails to live up to its very modern aspirations. Perhaps they are even an antithesis to feudalism. In the former Soviet Union post-socialism, with the breakdown or weakening of the state, there has arisen a new society based on patronage and personalism, and the state has become personalised, with patron-client relations now the new social arrangement in much of the former socialist world. There has been a growth of mafia-like elites and powerful groups that determine affairs, particularly at the local level. Yet, most people would not call these symptoms a sign of feudalism.

The economic changes in structure are also manifested in where people live. In 1951 when the first census in independent Pakistan was held, only 17 per cent of West Pakistanis lived in areas designated as urban; today estimates suggest that perhaps as many as 50–60 per cent live in cities and towns.[33] This shift has major repercussions which affect the economy, society, and the political process underway. In fact, in the context of Pakistan, perhaps the most important political factor over the last few decades, has been the process and extent of urbanization and the emergence, and perhaps consolidation, of a middle class.

Key indicators and trends suggest that Pakistan's agriculture has moved on to capitalist lines. For example, in the case of the share of marketable surplus produced by farms and agricultural units, a huge majority of farms produce primarily for the market, not for self-consumption—in the early 1950s around 12 per cent of produce was marketed, a figure which is now closer to 80 per cent;[34] there has been a marked decline of sharecropping which is being replaced by wage labour; the size of holdings have fallen sharply forcing owners to run farms for profit through production for the market using modern technology; there has been a noticeable shift towards cash crops and fruits, and orchards are now seen as viable economic units; and, commercial, market-oriented farming dominates all forms of agricultural production. Feudalism is no longer an economically viable and feasible project at the farm/landlord level, and many a 'feudal lord' has had to become a capitalist farmer or has then turned to other sources of income. While feudalism in Pakistan died its death a very long time ago, modern day Pakistan has seen the demise of agriculturists as a powerful economic, social, and political force. The old social structures associated with feudals have also been replaced by a market dominated form of existence—particularly, free and mobile labour—something which also explains the rise in poverty in rural areas as discussed in Chapter 22. The huge change in economic, social, and hence, political power, from the agriculturist, so-called feudal, lobby, towards an urban and rural middle class, is also one of the key indicators highlighting the extraordinary structural change in Pakistan in six decades.

What is being emphasized here is that while there are pockets of 'feudal-like' tendencies, feudalism as a dominating and organizing form of social and economic structure is no longer present. While Pakistan still has to develop a modern, democratic and socially responsible middle class and culture, the absence of this social group does not imply the presence of feudalism. With changes in landholding and the rise of the *arthi* and transporter as key economic and political figures in rural areas, and with inheritance laws breaking large landholdings, the old power structures based on land, have changed conspicuously.

What we have tried to do in this section, is to look at some of the characteristics of Pakistani society and show that they are not necessarily either special to Pakistan or to feudalism, and are common, in varying degree, across cultures and social systems. The so called feudal mindset or attitudes, are found in different undeniably non-feudal societies. We also want to state why this discussion here and in this Chapter

on feudalism is necessary. The reason is that when people believe that Pakistan is 'feudal' or that so-and-so is a feudal, or that a particular attitude is feudal, they often reduce their understanding and explanation to everything being 'feudal'. They will then not think beyond this and by putting things in a feudal pigeon-hole, they will sit back and say that this happens on account of feudalism, implying that nothing can be done about this unless feudalism is done away with. But on the other hand, if we argue that there is no feudalism, we are forced to analyse institutions and behaviour in a more serious manner and to examine the real causes of that behaviour or action. Blaming everything on feudalism takes the easy, and in this case, incorrect, path—see Appendix 2.2 on the numerous and different problems in theorizing feudalism.

2.5 Summary and Further Reading

2.5.1 Summary

This chapter has discussed the issue of the mode of production in agriculture in Pakistan. More specifically, it has tried to show that feudalism, despite popular perception, does not dominate production in the agricultural sector. A major reason why people believe that feudalism is prevalent in Pakistan is that they equate large landholdings with feudalism. This chapter has used a common and general definition of feudalism which has very specific characteristics, not dependent primarily on size of landholding. We have argued that, from the time of the British colonization of India, certain structural conditions were established by the imperial government which laid the foundations of capitalist development in agriculture. The rights of private property ownership and inheritance, defended by British civil law, brought forward this new form of production in agriculture. Although 'feudal' enclaves existed at the time of independence, their trend was on the decline, being replaced by an altogether different and new order.

2.5.2 Further Reading

To understand the concept of feudalism, capitalist development in agriculture and the process of transition, see:

Hindess, Barry and Paul Hirst, *Pre-Capitalist Modes of Production* (London: Routledge and Kegan Paul, 1975); Hindess, Barry and Paul Hirst, *Modes of Production and Social Formation* (London: Macmillan, 1977); Hilton, Rodney (ed.), *The Transition from Feudalism to Capitalism*, (London: Verso Books, 1976); Anderson, Perry, *Passages from Antiquity to Feudalism* (London: New Left Books, 1975); Marx, Karl, *Capital*, vol. 1, (London: Penguin, 1975); Marx, Karl, *Grundrisse* (London: Penguin, 1973); and Lenin, V. I., *The Development of Capitalism in Russia*, Collected Works vol. 3 (Moscow: Progress Publishers, 1977).

For material on Pakistan/South Asia, see:

Habib, Irfan, *The Agrarian System of Mughal India* (London: Asia Publishing House, 1963); Habib, Irfan, *Essays in Indian History: Towards a Marxist Perspective* (New Delhi: Tulika, 1995); Hamza Alavi et al. *Capitalism and Colonial Production* (London: Croom Helm, 1982); Belokrenitsky, Vyacheslav, *Capitalism in Pakistan: A History of Socioeconomic Development* (New Delhi: Patriot Publishers, 1991); Ali, Imran, *The Punjab Under Imperialism, 1885–1947*, (New Delhi: Oxford University Press, 1989); Vanguard Publishers, *Studies in the Development of Capitalism in India* (Lahore: Vanguard, 1978); Hamid, Navaid, 'The Process of Agricultural Development: A Case Study of the Punjab', unpublished PhD dissertation, Stanford University, California; and Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981).

For investigating the issue of feudalism in the South Asian context, the following books will be essential:

Jha, D. N., (ed.), *The Feudal Order: State, Society and Ideology in Early Medieval India* (New Delhi: Manohar, 2000); Sharma, R. S., *Early Medieval Indian Society: A Study in Feudalisation* (Hyderabad, India: Orient Longman, 2001); and Mukhia, Harbans, (ed.), *The Feudalism Debate* (New Delhi: Manohar, 1999). The collection of essays in Mukhia's *The Feudalism Debate* is recommended. The recent publication by Panos South Asia, particularly the contribution by Haris Gazdar, is also .recommended, not just for the discussion on the nature of landownership and the mode of production, but also discussions on agrarian reforms in Pakistan. See, Panos South Asia, *Leveling the Playing Field: A Survey of Pakistan's Land Reforms* (Kathmandu, Nepal: Panos South Asia, 2011).

Appendix 2.1

The Land Systems of Pakistan in 1947

Mahmood Hasan Khan has given a graphic description of agrarian economic and social relations of production in Pakistan at the time of Independence. He writes:

> There were essentially two land systems in the Indus basin, with regional variations in tenurial arrangements, in layers of intermediaries on land and in the degree of land concentration. The dominant among these two was the landlord–tenant system. The other system was of peasant-proprietors or owner-cultivators.
>
> While precise estimates on owners, tenants, etc. are not available for 1947, it is estimated that over 75 per cent of the agricultural population was of peasant-proprietors and tenants in the Punjab and Sindh. It is also estimated that most farms in Sindh were operated by *haris* and they cultivated over 50 per cent of the cultivable area. In the Punjab, over 58 per cent of the cultivated area was farmed by *muzaraeen*. Landownership was highly concentrated in both provinces. Owners of holdings of over 100 acres constituted only 2 per cent and 9 per cent of all owners in the Punjab and Sindh, but they owned 41 per cent and 52 per cent of area in the two provinces. The really large landowners, with holdings of over 500 acres, constituted 0.5 per cent and 1 per cent of all owners, but owned 25 and 30 per cent of the area. . . . Peasant-proprietors, with holdings of 5 acres or less, were evidently more numerous in the Punjab than in Sindh: 67 per cent of all owners in the former and 30 per cent in the latter. However, they owned only 30 and 4 per cent of all area. Most of these peasant-proprietors were in the newly settled and irrigated areas (canal colonies and central districts) of the Punjab.
>
> In the landlord–tenant system, the first group controlled most of the land, although it was small in number. The second group, though numerous, owned no land and enjoyed few if any permanent or recognized rights to its cultivation. The *zamindars* had rights of ownership which were heritable, partible and alienable. Only some *jagir* lands were not heritable. Most *zamindars* parcelled their lands out to tenants in small lots, usually of less than 15 acres. A *zamindar* used an *ahalkar* or a *kamdar* (supervisor) on tenants. He paid to the state as land revenue about 50 per cent of his net rental share in the Punjab (and 33 per cent in Sindh) for each matured crop.
>
> The tenants were mainly landless sharecroppers, who traded their labour and that of a pair of oxen for a return which in theory was about one-half of the crop output they produced on [the] *zamindar*'s land. The tenants supplied seeds and implements and paid water charges, but they did not pay land revenue to the state. The *haris* in Sindh enjoyed no legal rights on tenancy: their contract with *zamindars* was verbal and annual. Similar terms existed for the ordinary *muzaraeen* in the Punjab. For *maurusi muzaraeen*, their tenancy rights and contract with *zamindars* were to be regulated by the Punjab Tenancy Act of 1887. The conditions of occupancy for these tenants were by no means easy to fulfil in practice, reducing their status to that of tenants-at-will.
>
> There were then two basic features of the landlord–tenant relationship on land, namely (1) the *batai* system, and (2) the temporary tenure a tenant held at the pleasure of his landlord, who at least in Sindh regulated the tenancy by a system of shifting cultivation. The *batai* system had two parts. First, there was the distribution of crop shares between landlord and tenant on a 50:50 or 40:60 basis. Second, a *zamindar* charged his tenant *abwab* or *huboob*, which ranged in number from five to twenty. Their number depended on tradition in a particular area. Their total bite on a tenant's share varied from about 5 to 30 per cent. Many tenants-at-will were also required to provide *begar* to *zamindar* on demand. In Sindh, a *zamindar* assigned to a tenant each year a different parcel of land, supposedly to rotate crops in a water-scarce agricultural system.
>
> In disputes arising from the *batai* system, no legal protection existed for the landless tenants in any area. Even in the case of occupancy tenants in the Punjab, where such legal protection did exist, the political influence of a *zamindar* with revenue officials at the local level determined the outcome of disputes. Like much else, the *batai* system was maintained by the power of *zamindars*. More significantly, this system of crop sharing militated against the development of agriculture as it was unjust to tenants in the extreme. There existed no incentive for the tenant to expand production. By the same token, it did not create any pressure on the landlord to undertake investment to make crop production more efficient. With the ownership of large landed estates concentrated in the hands of these *zamindars*, it encouraged absentee landlordism. The transfer of surplus from the tenant to the *zamindar* was ensured by the social and political power enjoyed by landlords in the society, buttressed of course by the legal and administrative structure of the state.
>
> Peasant-proprietors played an important role only in the newly settled areas of the Punjab. Many of these cultivators had lost their lands to moneylenders. Those who survived faced a new menace resulting from increased fragmentation of holdings. Fragmentation of holdings intensified because of rising population on land and operation of the customary law of inheritance among Muslims. In some areas, many of these small owners could not sustain their families entirely on their own holdings. They became progressively tenants as well. So their existence was only slightly less precarious than of the landless tenants.
>
> Differences though there were between the Punjab and Sindh provinces, the rural scene in the Indus basin was dominated by two factors. Most power resided in the hands of those who were small in number but whose economic contribution to agricultural output was that they owned and controlled large tracts of land. Most peasants, on the other hand, were landless tenants and small owners. The tenure of the landless tenant was tenuous and the existence of small owner was only slightly better. The asymmetrical relations in this predominantly landlord–tenant system were maintained

and reinforced by the monopoly power of the absentee landlords and supported by the state. The characterization of tenants, no matter which source one cares to select among many, clearly established them as cultivators who had low economic and social status and whose surpluses were transferred to a dominant class of rulers, the *zamindars*.

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), 130–4.

Haris Gazdar provides a complementary analysis with specific focus on the Punjab and Sindh under the British.

Punjab

In Punjab (and settled NWFP), the colonial administrators decided to implement the *mahalwari* system of land revenue. This system was based on recognizing the village as the basic unit of land administration. The *mahalwari* system was in place in the western parts of what is now Uttar Pradesh, and Punjab was seen as an administrative extension of north-central India. The introduction of *mahalwari* in the later additions to the Bengal Presidency came after an acknowledgment on the part of the colonial government that the earliest land revenue systems (the zamindar-based Permanent Settlement of Bengal) had failed to create incentives for agricultural improvement.

Colonial officials surveying Punjab argued that the village already existed as a coherent and robust unit of land and social administration. What remained to be done was to document local variations and assign revenue liabilities and political responsibility to specific individuals, families, castes, and classes. It was acknowledged from the outset that in some parts of Punjab—notably the south-western region which now constitutes the southern part of Pakistani Punjab—the concept of the village was less well-established than the central and northern regions. Here, the predominant social unit was the well, around which populations were settled.

The village-based system of land settlement had three important features. First, the village was the basic unit of land revenue liability, and hence the basic unit of land holding. Villages could, of course, be shared between several landholders, in which case they shared the responsibility for land revenue, and were recorded as joint holders of the village. The land of a village would include cropped area, residential land as well as uncultivated land in private or collective use. Second, the village register was the record not only of land but of the entire village populace, including landholders, but also tenants, labourers, and people belonging to non-farm professions and trades. Third, the village was treated as the basic unit of administration—not only for the purposes of land revenue, but for all civil purposes.

Land settlement officers were always at pains to point out that their primary task was to identify, record and formalize existing arrangements of land holding and revenue liability. Local variations in the general village model were scrupulously noted and incorporated into district-wise settlements. At least three different types of *mahalwari* arrangements were used. A zamindari village was one where the entire village land was the revenue responsibility of just one landholding family. In villages where families had divided their holdings a *pattidari* arrangement was in operation. There were yet, other villages where it was argued that the entire 'body of the village' was the joint holder of the village regardless of whether or not they claimed common ancestry. Such villages were known as *bhaichara* villages.

In fact, all three types of settlements were variants of landlord villages. The 'village body' was meant to include only those families that claimed to be the possessors of land. The colonial officials used terms such as 'land owners' but it is clear from the records that the institutions of private property did not actually exist. It was the self-acknowledged task of the settlement officials to identify the true possessors of the land and to record them as its 'owners' through their individual or joint ownership of the mahal or the village. The mention of collective ownership in the settlement records actually referred to joint possession among a sub-set of all residents who claimed to be the landlords. It was taken as given that there will be other residents belonging to subaltern castes and classes whose position would be subservient to that of the recognized village land holders. In determining rival and contested claims of village land holding, the revenue officials paid explicit attention to political power, lineage, right of possession through conquest, and caste hierarchy.

Although the stated purpose of the settlement was to assign revenue tax liability, its effect was to confer private property rights in land to various classes of landholders. Before the colonial land settlements, there was no clear notion of the alienability of land. This can be seen from the fact that while discussing the provenance of any particular claim of land holding the key tests were actual possession (existing hierarchy of rights within a village) and the right of possession through conquest (genealogical tracing of invaders), but not any record of sale or purchase. It is not altogether surprising that the alienability of land—or accepting ownership rights of land holders—quickly led to actual alienation of land. Within a few decades of the land settlements the colonial government in Punjab faced protests on the part of the 'farming community' against the debt-induced alienation of land to urban money-lenders. Its response was to enact the Punjab Alienation Act of 1900, which classified rural society into 'cultivator' and 'non-cultivator' castes and tribes, and restricted the transfer of land ownership from the former to the latter.

Individual private property rights, therefore, were introduced in the favour of the landholders, and then modified to protect this same class. The land settlement in Punjab elevated the landholders but marginalized all other rural classes. Agricultural tenants, labourers, and non-cultivating service castes of various types that had traditionally enjoyed claims to the produce of land alongside the landholders were now dispossessed. In the late 19th century the 'non-agricultural' castes made up around half of the total population of Punjab. The majority among these 'non-agriculturalists' comprised the so called 'vagrant and menial castes' that actually performed much of the hard labour within and outside the agrarian economy.

Even among the half of the population that made up 'agricultural' castes, only a minority were landholders—others

were tenants of various types. Thus, the landholders' advantage over other classes which was previously tempered by a system of customary obligations was both magnified and qualitatively intensified when land was legally accepted as their property.

The Punjab settlement was overtly guided by political considerations. The colonial government consciously sought to create a class of loyal landowners consisting of the middle- and large-income peasantry. By freezing the hierarchy actually observed at a given moment in time into a perpetual contract through the creation of private property rights, the colonial settlement put in place considerable hurdles before the subaltern castes and classes. Whereas before the land system would have been subject to negotiation and change in response to changing local economic and political conditions, now the administrative machinery of the modern colonial state was geared towards preserving the particular balance of political power that happened to have prevailed in the mid-19th century Punjab.

Sindh

The *ryotwari* system appealed to the early 19th century sensibilities of British colonial officers for its simplicity and efficiency. Unlike the zamindar-based Permanent Settlement, this system did not recognize or create a class of intermediaries. Revenue liability was affixed to specific plots of land, and this created prefect incentives for cultivators to maximize their output. Unlike *mahalwari* this system also did not require the existence of village communities or the state's detailed involvement in documenting the structure of rights and claims within villages. Initially the leases were for specific periods of up to five years. Subsequent leases were for longer periods. This system promised to be the closest to a market in land. The *ryotwari* system was implemented all over the Madras Presidency and was also adopted in the Bombay Presidency. Parts of the Bengal Presidency too were brought under *ryotwari*. . . .

. . . The problem, of course, was not with the organization of Sindh agriculture. It was what it was, and had served the economic needs of the agrarian classes and the state to a lesser or greater extent. The problem was with the Indo-centric approach of the British colonial settlement which demanded the agrarian structure of a far-off corner of the imperial domain to obediently submit itself to prior administrative categories. Since this was not going to happen, and a decision needed to be taken, the colonial officials developed the thesis that the haari was 'but a serf of the soil'. The Sindh zamindar was recognized as the landholder and cultivator—that is, as the ryot with whom the *ryotwari* settlement could be made. Private property in land had been introduced and its principal beneficiary was the zamindar. At a stroke, the Sindhi haari was actually turned into a serf of the zamindar.

Source: Gazdar, Haris, 'The Fourth Round, and Why They Fight On: the History of Land and Reform in Pakistan', in *Leveling the Playing Field: A Survey of Pakistan's Land Reforms* (Nepal: Panos South Asia, 2011), 16–18, and 20–22.

Appendix 2.2

The Myth of Feudalism

This colourful article, written by Ayaz Amir in *Dawn*, re-emphasizes the point that feudalism still causes a great deal of concern to most people in Pakistan. Despite the considerable evidence presented to the contrary, the myth of feudalism prevails.

> There can be little doubt that next to the great buzzwords of corruption, good governance and the environment, the most overworked concept in Pakistan today is that of feudalism. Commentators who have never spent a night in a village or ever set eyes on a patwari, talk freely about waderas and feudal culture, ascribing all the country's political problems to these twin phenomena.
>
> There is a gross misconception at work here because while there is nothing healthy about feudalism (except insofar as it led in Europe to the rise of the mercantile classes and in time to the establishment of democracy), feudalism proper, with its vast landholdings and tenant farmers, is certainly not as widespread or potent a circumstance in Pakistan today as it was, say, in the first two decades of the country's history or as it continues to be in the feverish imaginations of our deskbound political analysts.
>
> About the only regions of Pakistan where we still find large landholdings is the province of Sindh and the Seraiki or the southern belt of Punjab. In the Frontier there were few large landholdings to begin with. If there are any today they must be few in number. In most districts of Punjab—a province which was once the centre of a thriving feudal tradition—large estates are a thing of the past. More than the imperfect land reforms of Ayub Khan and Zulfikar Ali Bhutto, what has been responsible for this development are the laws of inheritance with what were once large estates becoming smaller holdings.
>
> The result of this process is not hard to see. In pockets of Mianwali and Attock districts there are still a few large landholdings. But in the districts of Rawalpindi, Chakwal, Jhelum, Mandi Bahauddin, Gujrat, Wazirabad, Gujranwala, Sheikhupura, Lahore, Kasur, Sialkot, Narowal, Faisalabad and Toba Tek Singh (this by no means being an exhaustive list) there are no big zamindars, the norm in these districts being of small peasant proprietors or farmers with middle-size landholdings. It is true that citrus growers and mango and cotton farmers of central and southern Punjab make fat profits every year. But that is because of the cash crops they cultivate and not because all of them are sitting atop rolling vistas of farmland. In Tehsil Bhalwal of Sargodha district, for example, even small farmers with citrus gardens of, say, 15 or 20 acres are able to get a good yearly return. But that scarcely turns them into feudals.
>
> Not that feudalism, as a form of land tenure, has disappeared completely from Punjab. But it is confined to small pockets—Dera Ghazi Khan (courtesy the Legharis and

Mazaris) and parts of Multan, Sargodha, Bahawalpur and Rahim Yar Khan.

The urban misconception of course is that anyone who looks like a hick, dresses like one, has a rural surname, curls his moustache and rides a Pajero (or as is the case nowadays, a Turbo Cooler) is necessarily a feudal. The Punjab provincial assembly certainly looks like a rural assemblage. But that is because most of its members are from rural backgrounds and represent rural constituencies and not because they are feudals. Just as every Memon, Gujrati or Chinioti is not a captain of industry, every Chattha and Warraich or Malik and Chaudry is not a feudal landlord.

The question raised in discussions about feudalism, however, is not about the size of landholdings but about the pernicious consequences of this phenomenon, with feudalism, in urban discourse, being considered almost synonymous with political power. The argument advanced is that parliamentary democracy has been unable to establish itself on a sound footing because feudals with their retrogressive ways, have a strangle-hold over the assemblies. This is a distorted view of Pakistani politics. Rural interests have a predominant influence in the assemblies simply because, reflecting the concentration of population, there are more rural constituencies in the country.

Feudal influence in politics received a major blow in the 1970 elections when big-name feudals in Punjab tasted defeat at the hands of less well known candidates from the Pakistan People's Party. Later, it is true, Zulfikar Ali Bhutto tried to reverse the process he himself had set in motion by admitting some of the same feudals into the PPP at the time of the 1977 elections. Even so, there was no going back to the politics of the forties and fifties when feudalism automatically meant political power.

Today, in Pakistan few landholders, no matter how big, can make it into the assemblies if they are not supported by one or the other of the two major parties: the PPP and the PML(N). This is true even of Sindh where a PPP ticket counts far more than being a wadera. Jatoi needs PPP support to win in Nawabshah. After several defeats, Mumtaz Bhutto (no small landowner) made it to the Sindh assembly with some difficulty during the 1993 elections. The Pir of Pagaro has been trounced several times by PPP candidates. Indeed, it is a measure of the change in Pakistani politics that with the exception of the Bhuttos in Larkana, Nawaz Sharif in NA-95 Lahore, the Legharis and Mazaris in D. G. Khan and Khar in Muzaffargarh (and possibly Shaikh Rashid in Rawalpindi) few other politicos can claim to have safe constituencies. Even in this list, it is only in D. G. Khan that feudal influence can be seen as the decisive factor for electoral success. The Bhuttos win in Larkana not because they are big landowners (there being other big landowners in the district as well) but because of their famous surname. Even Khar is not quite the big feudal that Tehmina Durrani has made him out to be. The clout that he enjoys in his district is because of his political standing which is quite independent of his landowning status.

The fact, however, remains that in Pakistan today, when political ideology has taken a back seat to the pursuit of power for its own sake, a party ticket alone is not a sufficient condition for election success. In order to produce the desired results it must be matched with local influence. So the question really is that if feudalism is a waning force, what are the other factors which make for rural influence in Pakistan today?

There is none more important in this respect than the ability to interact with the local bureaucracy: the police, the magistracy and the revenue department. The administrative system in Pakistan is riddled with corruption and inefficiency. If it responds to anything it is to graft and influence-peddling. In order to win the kind of influence which can later be translated into votes, a politico first has to be 'available' to his constituents, the days of absentee politics having long gone in Pakistan. But availability is of use only when the politico concerned is wise to the politics of *thana*, tehsil and *katcheri*. At one time it was mostly the feudal who performed this role. Nowadays his place has been taken by other representatives of the rural gentry: those who have disposable incomes because of their cash crops or those who have made money in other fields: transport, construction, light industry, the Gulf, etc.

So, if anything has to be reformed or changed it is not just the remaining bastions of feudalism, but the administrative system which still puts a premium on a feudal style of politics. As long as the administrative system continues to function in its present groove the rural population will understand local power-brokers better than candidates who may otherwise be better qualified to speak glibly on national and international issues.

This is not to say that with the breakdown of feudalism Pakistani politics have become more egalitarian. That is far from being the case. It is only in this that the nature of the Pakistani oligarchy has changed. It is no longer neatly divided into the bureaucracy, the military and the landowning class as it was for the first decade of the country's history. Today all these various segments (plus high finance and industry) have come closer to each other through inter-marriages and a commonality of economic and political interests. Retired generals and bureaucrats are landowners and captains of industry. Former landowners are industrial barons. The old industrial houses have married into the old feudal aristocracy. A new moneyed breed has entered politics. The old familiar societal distinctions, therefore, have lost much of their validity.

If the cause of egalitarianism has to be served then the enemy is not just feudalism (which in any case, as I have tried to show, has lost much of its traditional power) but an incestuous oligarchy which dominates social, political and economic life in the country. To keep the focus of public anger only on the Pajero-riding rural politico is to ignore the evolutionary complexity of this elite whose depredations have brought the country to its present sorry pass.

Source: Amir, Ayaz, 'The Myth of Feudalism', *Dawn*, 10 June 1996.

Appendix 2.3

The Complexities of Conceptualizing and Theorizing Feudalism

Do all societies follow a universal historical process, or path of development, moving through stages of an ancient, primitive, slave, feudal, and capitalist trajectory? Is the European model of history universal? The extracts presented here, all from eminent historians who have contributed to the edited volume *The Feudalism Debate*, throw some light on feudalism and on method in historical analysis.

1. Whenever we discuss the question of feudalism in any country and in any period, medieval Western Europe inevitably provides the point of reference for such a discussion, whatever be our answer to this question. One can, of course, see the justice of comparing the history of other countries with that of Western Europe in modern times for it was, after all, in Western Europe that capitalism arose which was later to encompass the whole world; but it is difficult to see the logic of such a comparison in the ancient and medieval periods when it might only persuade us to ask questions which have so little relevance to our history.

   It is possible, of course, to speak of regional variations of feudalism. One could thus argue in favour of an Indian feudalism, a Chinese feudalism, a West Asian feudalism, etc. apart from the West European and the Japanese one. However, I visualize two reservations with respect to this argument. First, the use of a common denominator for the whole range of regionally and temporally variant socio-economic systems could hardly be justified unless one could establish a fundamental similarity underlying these variations—a similarity that was precisely defined. Second, quite apart from the fact that feudalism as a category achieves universality only through the looseness of its definition, the very search for a universal category, equally applicable to different medieval regions, is based on the assumption that the medieval world was one world sharing a common socio-economic system. We thus attribute to the medieval world characteristics which more appropriately belong to the nineteenth and twentieth centuries.

Source: Mukhia, Harbans, 'Was there feudalism in Indian history?', in Mukhia, Harbans, *The Feudalism Debate* (New Delhi: Manohar, 1999), 81.

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2. Rather than work out the implications of their analysis, Chinese historians, in their loyalty to a universal teleology, continue to introduce by the back door standards of development derived from European history. This is most evident in the preoccupation with the 'sprouts of capitalism' which implies that even if China had its own 'special' laws of development, Chinese development nevertheless anticipated the universal goal of historical development: capitalism. In spite of its 'special' development, therefore, feudalism in China is portrayed as the stage prior to capitalism in a universal model of development. The result has been to enlarge the concept to encompass all pre-capitalist agrarian society. . . .

   . . . Problems of the Chinese conceptualization of feudalism are not peculiar to Chinese historical discourse but are universal problems of the discourse on feudalism. These problems are products of what Isaiah Berlin has described as the 'inflation' of concepts, the accretion of new meanings to a concept as the concept is made to correspond to the different realities which it is used to represent. Feudalism certainly has undergone such inflation as it has had to accommodate widely different realities in its worldwide diffusion. These problems exist no matter whether we speak of Chinese feudalism, Japanese feudalism, Latin American feudalism, African feudalism, Russian feudalism or whatever. In order to describe these societies as feudal, it has been necessary on the one hand, to ignore significant structural differences among them, and, on the other hand, to inflate the meaning of feudalism to accommodate such structural differences. Feudalism has come to describe anything from a European political-economic institution to all post-slave pre-complaint agrarian economics.

Source: Dirlik, Arif, 'The Universalization of a Concept: "Feudalism to 'Feudalism' in Chinese Marxist Historiography", in Mukhia, Harbans, op. cit., 169.

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3. In the case of Marxism, however, the assumption that history must develop through a number of stages imposes more serious restrictions on historical analysis. Since feudalism must precede capitalism as a stage, a society that exhibits 'capitalist' elements but cannot be categorized as capitalist must by definition be a feudal society. This lack of alternatives lies at the root of the circular and contradictory arguments that while China was a 'special' feudal society because it never made the transition to capitalism, it was a special feudal society because it contained important capitalist elements.

   This is a general problem of the Marxist conception of history as a succession of internally related modes of production culminating in capitalism and, ultimately, socialism. Whether or not Marx intended European development to be universalized into a global model of development, which is debatable, Marxist discourse has been guided by this assumption. The only alternative to this unilinear scheme of development has been provided by the notion of Asiatic society which, as Western and non-Western Marxists have recognized, is the product less of theory than of a Europe-centred culturalism. Whether because of the imposition of a European model upon the rest of the world, or because of the culturalist exclusion of non-European societies from general theoretical considerations, Marxist models of development have proven deficient outside of Europe.

Source: Dirlik, Arif, op. cit., 176.

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4. The most serious reservation I have on this approach of comparative study of societies lies in its Eurocentricism. Why should Europe be accorded the privilege of providing yardsticks with which to compare non-European societies? Why should one use such terms as 'seigniorial rights', 'serfdom', 'sub-infeudation', 'manorial', etc. as Sharma, for example, does, in a way begging the question of similarities? Why should one not try to understand European society in terms of, say the caste system, zamindari, etc? Surely, one will find family resemblances in European institutions of these purely Indian types?

Source: Rudra, Ashok, 'Pre-capitalist modes of production in non-European Societies', in Mukhia, Harbans, op. cit., 327.

NOTES

1. See Habib, Irfan, *The Agrarian System of Mughal India* (London: Asia Publishing House, 1963); Habib, Irfan, 'Potentialities of Capitalist Development in Mughal India', *Journal of Economic History*, vol. 29, no. 1, 1969; and Habib, Irfan, *Essays in Indian History: Towards a Marxist Perspective* (New Delhi: Tulika, 1995).
2. The rest of this and the following section make liberal use of: Habib, Irfan, op. cit., 1963; Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981); Hamza Alavi et al. *Capitalism and Colonial Production* (London: Croom Helm, 1982); and Belokrenitsky, Vyacheslav, *Capitalism in Pakistan: A History of Socioeconomic Development* (New Delhi: Patriot Publishers, 1991).
3. Belokrenitsky, Vyacheslav, op. cit., 1991, 8.
4. Alavi, Hamza, 'India: The Transition to Colonial Capitalism', in Hamza Alavi et al. op. cit., 1982, 38.
5. Ibid. 38, emphasis added.
6. Khan, Mahmood Hasan, op. cit., 1981, 126.
7. Ibid. 143.
8. Belokrenitsky, Vyacheslav, op. cit., 1991, 37.
9. Ibid. 42.
10. Ali, Imran, *The Punjab Under Imperialism, 1885–1947* (New Delhi: Oxford University Press, 1989), 49.
11. For detailed documentation and discussion, see Ali, Imran, op. cit., 1989.
12. Belokrenitsky, Vyacheslav, op. cit., 1991, 134.
13. Ibid. 89.
14. Ibid. 93.
15. Khan, Mahmood Hasan, op. cit., 1981, 143.
16. Ali, Imran, op. cit., 1989, 235.
17. Ibid. 237.
18. Ibid. 241.
19. Ibid., 242, emphasis added.
20. Ibid. 4.
21. Ibid. 4.
22. Khan, Mahmood Hasan, op. cit., 1981, 130, emphasis added.
23. See amongst many: Marx, Karl, *On Colonialism* (Moscow: Foreign Language Publishing House, 1960); Habib, Irfan, op. cit., 1963; Alavi, Hamza, op. cit., 1982; McEachern, Doug, 'Capitalism and Colonial Production: An Introduction', in Hamza Alavi et al. op. cit., 1982; and Belokrenitsky, Vyacheslav, op. cit., 1991.
24. Belokrenitsky, Vyacheslav, op. cit., 1991.
25. See Alavi, Hamza, op. cit., 1982; McEachern, Doug, op. cit., 1982; and Belokrenitsky, Vyacheslav, op. cit., 1991.
26. Belokrenitsky, Vyacheslav, op. cit., 1991, 16.
27. Ibid. 29.
28. See Alavi, Hamza, op. cit., 1982; McEachern, Doug, op. cit., 1982.
29. McEachern, Doug, op. cit., 1982, 12.
30. Alavi, Hamza, op. cit., 1982, 64, emphasis added.
31. Another, equally interesting and persuasive description of this form of change has been brilliantly depicted by Zulfikar Ghose in his novel *The Murder of Aziz Khan*, first published in 1967. See, Ghose, Zulfikar, *The Murder of Aziz Khan* (Karachi: Oxford University Press, 1998).
32. Wilder, Andrew, *The Pakistani Voter: Electoral Politics and Voting Behaviour in the Punjab* (Karachi: Oxford University Press, 1999).
33. Some analysts suggest that Pakistan is now predominantly urban, with so called 'rural' areas fully integrated into the overall urban economy. See article by Reza Ali in Zaidi, S. Akbar (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003).
34. I am grateful to Professor Mahmood Hasan Khan for providing this information.

3 The Green Revolution and Land Reforms

It would be fair to say that one of the most important events in Pakistan's agricultural history, with extensive repercussions on other sectors, has been the process called the Green Revolution, which occurred in the mid-1960s. The technology package associated with it generated major changes in the economic, social, and political structure of the country, transforming the agricultural and rural sectors irreversibly. Much of what we see today, in terms of economic and social groups and classes, political affiliation, and even culture, has its roots in, and is a consequence of, the Green Revolution. It forms a watershed between the old and new Pakistan. However, while the mid-1960s are in many ways an important juncture in our history, it is necessary to emphasize that change is a continuous process and events like the Green Revolution act only as an impetus to that change. While present-day Pakistan may have its roots in the Green Revolution much more has happened since the mid-1960s to make Pakistan what it is today. This chapter will examine the nature and consequences of the major transformation that took place in the mid-1960s.

Land reforms are an important mechanism for changing ownership and wealth patterns, economic and social relations of production, political relations, and a host of other factors. Land reforms usually imply a redistribution of land away from those who own large chunks of it to those who are often landless (see Box 3.1). There have been two sets of land reforms in Pakistan, both of which will be analysed in this chapter.

The purpose of studying any sector or society is to see how it has changed over time and how it continues to evolve. In Chapter 2, we discussed the process of change in agriculture from the times of the Mughals until independence. This chapter discusses some important events resulting in the transformation of the agricultural sector, while the next chapter examines the overall process of agrarian transition. The events and issues discussed in the present chapter have an important bearing on how agrarian transition has taken place.

3.1 THE GREEN REVOLUTION

The annual growth rate in agriculture between 1949 and 1958 was a mere 1.43 per cent, less than half of the annual growth rate in population. Agriculture was allowed to stagnate in the 1950s because the ruling élite believed at that time that it was essential to industrialize at all costs and at great speed. Government policies were heavily biased against agriculture, and it was only towards the end of the 1950s—when it became clear that growth in agriculture was necessary for the survival of the country—that the importance of the agricultural sector was recognized.

Box 3.1

Land Reforms: Need and Constraints

Viqar Ahmed and Rashid Amjad examine the principle behind land reforms. They argue as follows:

> In agrarian societies, land is the primary productive asset and the tangible expression of economic and political power. Therefore, the struggle for control of land and its fruits is a constant one. Throughout history, patterns of land ownership and tenure have played an important, and at times decisive, role in shaping the political and social system. It has, in most cases, also helped to determine the possibility and pace of economic change. It was thus inevitable as economic development became a major goal in these societies, and the principal concern of governments, that large concentrations of land ownership and the feudalistic pattern of social relationships came to be regarded as prime obstacles to sustained growth and development. Demands for radical changes in the land-tenure systems became more and more persistent both on grounds of social justice as well as a pre-requisite for economic development. . . .
>
> . . . A decision to undertake land reforms often meets with strong resistance from landowners who constitute a powerful élite in agricultural societies. It is, therefore, preceded by political controversies and national debate. Even after a land reforms proposal passes through the legislative process, its implementation is a complicated task due to the lack of organization at the village level, a dearth of proper data, a faulty maintenance of land records, and lengthy and complex legal procedures. These obstacles can, of course, be overcome by a strong political will and the active support of the rural masses for the programme.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 117–18.

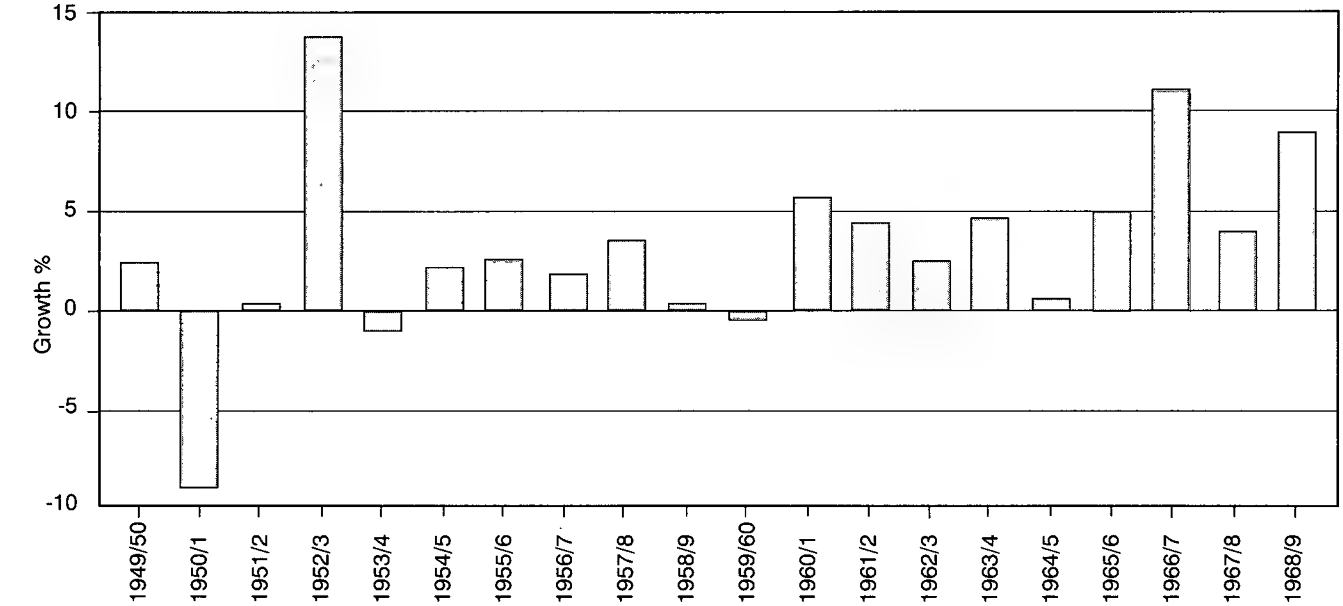


Figure 3.1
Growth Rates in Agriculture: 1949–69

Figure 3.1 shows the growth rates in agriculture in the 1950s and 1960s, and indicates a marked change between the two decades. Between 1959 and 1964, agriculture grew at an overall rate of 3.7 per cent, but this impressive rate was overshadowed by the even greater 6.3 per cent between 1965 and 1970. Between 1966/7 and 1967/8, the years when the Green Revolution was at its peak, agricultural output grew by 11.7 per cent, and it maintained a high growth rate of 9.6 per cent in 1968/9 to 1969/70. How were these rates achieved?

The phenomenal increase in growth took place in two phases. In the first, 1960 to 1964/5, the main cause of the growth was the increase in irrigation facilities, mainly tube wells. The second phase, between 1965/6 and 1969/70, showed impressive growth when the expanded irrigation facilities were supplemented by the technology package of high yielding variety (HYV) seeds, chemical fertilizers, and pesticides. Essentially, then, it was the complete package of water, seed, fertilizer, and pesticides that caused the large growth in agricultural output and production.

Without any doubt, *the most important ingredient in the technology package was water*, and water which was guaranteed and available as and when required. It was the key variable that established the spread of Green Revolution technology, since the new HYV seeds and the fertilizer package were critically dependent on the timely availability of a sufficient quantity of water. The increase in the availability of water, either by tube wells or through canals, was estimated to be responsible for half of the total increase in output.[1]

In the first phase, where irrigation was the critical component of agricultural production, privately owned tube wells were the main factor responsible for the increase in water availability. Between 1960/1 and 1964/5 about 25,000 tube wells were installed, each costing Rs. 5,000–12,000, and the farm area serviced by tube wells doubled.[2] In the second half of the 1960s, two HYV seeds, one for wheat, developed by the International Wheat and Maize Institute in Mexico, and the other for rice, developed by the International Rice Research Institute in the Philippines, were introduced in Pakistan. The Mexi-Pak wheat seed had been experimented upon in the early 1960s and, along with the IRRI rice seed, yielded higher output. These experimental results were soon reproduced across large areas of agricultural land. Since the HYV seeds required large sources of water, those areas that had better irrigation facilities and those that had installed tube wells were the first to adopt these seeds. Moreover, farmers who wanted to use the new seeds were also seen sinking tube wells and the number of tube wells in the country increased from 34,000 to 79,000 between 1964/5 and 1969/70. The area serviced by tube wells increased six-fold between 1959 and 1969. More than half of the irrigated area of the country (6 million acres) was cultivated with the improved seeds in 1969/70. Fertilizer consumption also saw a dramatic increase of 150 per cent between 1965/6 and 1970/1 and a rise of 235 per cent between 1965/6 and 1971/2.[3]

As Figure 3.1 shows, there were substantial increases in agricultural growth rates in each of the Green Revolution years. Moreover, the output of major crops between 1960 and 1970 increased substantially: wheat production by 91 per cent and rice by 141 per cent. Even other crops not directly related to the HYV seeds showed increases due to the extensive use of other non-seed factors in the package. So it seems that the Green Revolution, at least as far as production, growth, and output are concerned, was a resounding success. Nevertheless, we need to analyse the numerous issues and repercussions of this significant event in Pakistan's agricultural history.

3.1.1 The Issue of the Tube Wells

While the growth in tube wells from a few hundred in 1960 to 75,000 in 1968 and 156,000 in 1975 was a key factor in providing irrigation, and hence in permitting the adoption of the technology package, there are a number of issues around the apparently 'simple', and supposedly mere technical, issue of sinking tube wells.

The first issue concerns the location of tube wells: they were highly concentrated regionally, mainly in the rich, old, settled districts and the canal colony districts of the Punjab; indeed as many as 91 per cent of the 76,000 tube wells in 1968 were in that province. Outside Punjab there was very little tube well development. In the NWFP and Balochistan, the shortage of accessible supplies of ground water, due to the hard stony mountainous terrain, made the depth of drilling required for tube wells prohibitively expensive. In Sindh, the fact that ground water is saline meant that this water could not be used for agricultural purposes, and thus very few tube wells were sunk. Thus, it was not the entire province of the Punjab, but only a handful of districts in the Punjab that were able to sink tube wells and gain all the benefits of the Green Revolution. This, some observers believe, caused interregional disparities to grow (see below).[4]

Secondly, given their size and cost, tube wells were mainly installed by landowners with over 25 acres of land. Mahmood Hasan Khan writes that 'given the indivisible and large capacity of diesel and electric tube wells, even the middle peasants cannot afford their fixed and variable costs. Therefore, there has been a high concentration of ownership of tube wells.'[5] Seventy per cent of tube wells were put in by farmers owning over 25 acres, and only 4 per cent by farmers owning fewer than 13 acres.[6]

Thirdly, inducement to invest in tube wells was given to farmers through large public subsidies on fuel, installation costs, and maintenance. Moreover, the Agricultural Development Bank of Pakistan (ADBP) followed a fairly liberal credit policy and made numerous loans to farmers so that they could set up private tube wells.

Essentially, then, the apparently 'neutral' effect of increasing irrigation through tube wells seems to have had a number of important repercussions on interregional concerns, economic status, and the ability to borrow money. The extensive sinking of tube wells was far from scale neutral.

3.1.2 Tractorization

In Chapter 5, we discussed the critical issues in agriculture, an important issue examined is tractorization and mechanization. Tractors are now an important part of the agricultural and the rural scene, but their contribution during the Green Revolution had very important consequences. Akmal Hussain writes:

> tractor imports were systematically encouraged [after 1960] by the provision of cheap credit through institutions such as the ADBP. At the same time the overvalued exchange rate made tractors available in Pakistan at prices considerably below world market prices. Another factor stimulating tractorization was the greatly increased profitability of agricultural production, as the result of the availability of HYV of foodgrains, subsidized fertilizer, cheap electricity for tube well installation as well as improved provision of canal water following massive public surface water projects.[7]

Hence, due to the technology being used, tractors became more useful on the farm.

In 1959 there were 2,000 tractors in the country, which increased by over 8,000 per cent to 18,909 in 1968. Most of these tractors were of the larger size, with 84 per cent above 35 horse power. A World Bank Study of 1966 and the Giles Report in 1967 recommended the use of the larger tractors.[8] Once these tractors were imported the pattern was set, and large tractors still dominate today (see Chapter 5). Not surprisingly, most tractors were owned by those with more than 100 acres of land.

In a study in the early 1970s, Carl Gotsch reported that over 38 per cent of all tractors in the country were located in the Multan Division in Central Punjab, while 58 per cent were in the three divisions of Lahore, Multan, and Bahawalpur[9] There was also a very close link with tube well ownership, where almost 75 per cent of privately owned tractors were on farms that had sunk tube wells.[10]

Clearly, tractorization took place in those areas which had 'complementary inputs, [was] carried out by the larger and more resourceful farmers and [was] associated with a proximity to urban markets and services'[11]—similar to those found with tube wells.

3.1.3 Regional and Income Disparities

If tube wells were the single most critical factor that was responsible for the Green Revolution, and if the sinking of tube wells had a close correlation with tractorization, which in itself would have helped production further, a pattern emerges. Moreover, if we discovered another close correlation, that between large farms, in specific regions, and tractors and tube wells, the impact on regional and income inequality would be self-evident. Let us examine the evidence.

Hamza Alavi writes that 'because private tube well development is closely relative to concentration of land in large farms, the "Green Revolution" has tended not only to intensify already large disparities in income and wealth of the different strata of rural population but, by the same token, it has also widened disparities between different regions'.[12] He adds that the incomes of the rural élite increased, while the incomes of small farmers in the districts where the Green Revolution was most successful, and in other poorer regions, 'have failed to improve or have not improved in the same measure'.[13] These views are shared by most researchers on the Green Revolution. Moazam Mahmood argues that the inputs, especially the installation of tube wells and access to credit, were inaccessible to poorer farmers and, hence, that the latter did not share in the fruits of the Green Revolution, causing increases in relative poverty.[14]

Mahmood Hasan Khan says that, since the use of fertilizers and new seeds was premised on the availability of adequate water supply, the lack of water caused 'serious interregional

and intra-farm disparities'.[15] The NWFP and the south-eastern parts of Sindh had inadequate access to water and the HYV technology. The difference between the poor and rich peasants also increased due to the unequal access to inputs.

Carl Gotsch has argued that one should talk not of the increase in agricultural growth in Pakistan, but rather of growth in a relatively few districts. These districts in the Punjab–Lyalpur (Faisalabad), Montgomery (Sahiwal), and Multan—grew at 8.9 per cent per annum between 1959/60 and 1964/5, twice the 'national' rate. Thus, as Shahid Javed Burki has argued, it was the farmers who owned between 50 and 100 acres, almost all of them in the Punjab, who produced 'Pakistan's' Green Revolution.[16]

3.1.4 Élite Farmer Strategy and Capitalist Development

Some observers have argued that the Green Revolution was 'an élite farmer strategy because . . . it rest[ed] on the economic power of large landholders who [were] its principal beneficiaries'.[17] For them, this rural élite constitutes less than 5 per cent of the rural population of Pakistan and was the only real beneficiary of the Green Revolution. Akmal Hussain believes:

> The new technology made it possible to accelerate agricultural growth substantially through an 'élite-farmer strategy' which concentrated the new inputs on large farms. Now the crucial determinant in yield differences became not the labour input per acre in which small farms had been at an advantage, but the application of the seed–water–fertilizer package over which the large farmers with their greater financial power had superior access. Thus the technocrats felt that the Green Revolution had made it possible to accelerate agricultural growth without having to bring about any real change in the rural power structure.[18]

Despite (or possibly because of) these anomalies in the benefits of the Green Revolution, one outcome upon which all observers are agreed is that the Green Revolution resulted in the development and entrenchment of capitalist farming in the regions where the technology was adopted. However, there are some differences of opinion over who were the leaders of this change in the mode of production and in farming techniques.

Shahid Javed Burki and others believe that the rapid agricultural growth was led by a new breed of dynamic middle-class farmers who were capitalist to start with. These farmers had been created by the shift in political power under Ayub Khan, who, Burki argues, through his Basic Democracies scheme took away political power from the traditional big landlords and gave it to the middle-class landowners. It was these middle-class farmers, owning between 50 and 100 acres of land in the Punjab, who 'produced' the revolution in Pakistani agriculture. Ayub Khan's creation, the rural middle class, was considered a 'new powerful and independent factor in the political system', which had been 'released from the political and rural control of the landed aristocracy' and emerged as the 'traditional profit maximizer'.[19]

This view has not been shared by the likes of Hamza Alavi and Akmal Hussain, who believe that it was the large landlord and not the middle class which was at the vanguard of this revolution.[20] They believe that farmers who had land over 100 acres were dominant in the adoption of the new technology and in reaping the fruits of the Green Revolution. Alavi feels that the new mechanized methods did not bring into existence a new class of capitalist farmers, but that it was 'mainly the big landowner who . . . made the greatest progress in the direction of farm mechanization'.[21] Nevertheless, they all agree that the impact was one of deepening capitalist relations.

There was increased leasing-in of land as large farmers were now willing to take back the land previously leased to sharecroppers. Due to the large scale of tube wells and tractors, more and more land was resumed for production under capitalist means. Not only that: owners of this technology began to lease-in their neighbours' land as well. These farmers began to evict tenants or send them to more marginal portions of the land, and began to hire wage labour instead. Self-cultivation was on the increase in areas where this technology was used. There was greater income in the hands of landowners, who began to purchase manufactured goods. As demand and consumption expanded, markets began to emerge around small towns. A number of attributes particular to capitalism (see Chapter 2) began to dominate in the agricultural sector, probably ending once and for all the debate on whether agriculture in Pakistan was feudal or capitalist. Capitalism had entrenched itself forcefully and permanently.

3.1.5 Social and Political Effects

Although the economic effects of the Green Revolution were easily observable, with growing overall output and increasing incomes for some, the social and political effects took a little longer to emerge. Amongst the economic factors that had social and political impacts were: the displacement of labour, both at the low end of the spectrum in the form of sharecroppers, and at the higher end, where those with land either sold it or rented it out to neighbours; increased rural–urban migration; an increase in consumerism; the emergence of small towns near agricultural areas that were using capitalist techniques, and hence required new and different services; and the awareness of disparities between farmers and regions.

There was also a change of attitude towards education, especially amongst the big farmers. Writing at that time, Hamza Alavi argued that 'the revolution in mechanical technology and chemical technology which is now employed in agriculture is making new demands upon the capabilities of the farmers. They are becoming increasingly aware of the values of education in terms of their own situation, namely for better farming and coping with new technologies.'[22] However, the emphasis upon the social sectors was not particularly impressive in the 1960s and education was not considered important by the Ayub Khan regime (see Chapter 19).

Before the Green Revolution there was a lot of talk about the small farmer and how efficient he used to be. However, as the new technology spread, the size–efficiency relationship was reversed: rich peasants and landlords made most and best use of the lumpy investments in a technology that, as we have seen, was not scale neutral and was biased in favour of the large landlord. Mahmood Hasan Khan argues that 'the structure of technology and the direction of credit flows themselves reflect the influence of large landowners and capitalist farmers on public policy'.[23] Moreover, it is important to emphasize the fact that, since Punjab and Sindh are the backbone of Pakistan's agricultural economy, with more than 75 per cent of the country's population, and 80 per cent of its cultivated and cropped area, the impact of the Green Revolution was restricted to these provinces. Moreover, because of the water and technology packages identified above, the NWFP and Balochistan missed out on the Green Revolution of the 1960s. (However, Chapter 5 reveals some interesting recent trends regarding increases in output and production in these two provinces.)

Nirmal Sanderatne has been particularly observant about the political consequences of the Green Revolution and relates them to the rise and subsequent victory of the Pakistan People's Party in 1972. He argues that 'the overwhelming electoral victory of the PPP amply justified its strategy [of making promises to the peasantry on agrarian reform] and demonstrated the validity of the hypothesis advanced earlier that the nature of agricultural development in the past, while successful in terms of increasing aggregate production, had intensified existing economic disparities and dissatisfactions. In turn these had radicalized Pakistan's politics.'[24] The PPP won conclusively in the heartland of the Green Revolution and some observers found a 'high correlation between the voting for the PPP and the area under Mexi-Pak varieties of wheat. The PPP won in all but one of the constituencies in which more than 56 per cent of the wheat area was under the new varieties.'[25]

The emergence of the Pakistan People's Party on the Pakistani political scene and its subsequent victory in the 1970 general election were the result of the policies of Ayub Khan's decade. The election results from the rural areas were a direct consequence of the Green Revolution, and even urban areas were not spared the outcome of agrarian change as migrants from rural areas began to play some role in industrial and urban areas as well. With hindsight, one can say that the 1970 election, with the victory of the Awami League in East Pakistan and the People's Party in West Pakistan, may have been the only election held in Pakistan where economic conditions so directly influenced political outcomes. Perhaps it was the degree of turmoil and disparity that emerged after the Green Revolution of the 1960s, as it usually does after any revolution, which made such politics possible. Since then, development in Pakistan has probably been less disharmonious, and hence change has been more gradual and less disruptive. The Green Revolution was the first big shock that disrupted gradual growth, especially in agriculture, but also more generally across Pakistan. There is little doubt that it radically transformed the economic, political, and social direction of the country, establishing deeper, more entrenched, capitalist relations of production than those that had existed earlier in agriculture.

Development and growth, especially of capitalist relations, is a disharmonious process, often creating but also destroying, and having negative consequences for some sections of the population. However, one needs to examine the overall nature of development. Hamza Alavi, for example, argues that 'the present course of the "Green Revolution" . . . has brought about a deterioration in the conditions of life of a majority of the population and further progress of farm mechanization is creating a situation when a very large number of the rural population is faced with the prospect of having no viable means of livelihood'.[26] At a micro level this scenario did happen, but this analysis ignores the impact of the greater dynamic of change (even progress) that resulted in the use of this technology. Moreover, Hamza Alavi's lament ignores his own analysis where he recognizes that the Green Revolution was geared to the needs of large landowners, and was even made by the bureaucracy in tandem with their class allies, and hence that the outcome was inevitable. Any other outcome, given the nature of the state, class alliances and the focus on large landowners, would have been unlikely.

Akmal Hussain, too, falls into such a trap. He realizes that the new technology did accelerate growth in agriculture substantially through an élite farmer strategy, and that the 'growth of capitalist farming accelerated considerably in the late '60s as large landowners began to resume rented out land to operate their own farms with hired labour and capital investment'.[27] But, for Akmal Hussain, 'it was this process of the development of capitalist farming which has generated new and potentially explosive contradictions in Pakistan's rural society'.[28] Again, any other outcome would have been unlikely. Given the existing contradictions, class alliances, and the role of the state, the result was a natural consequence of the policies followed.

3.2 Land Reforms[29]

Pakistan has had a long and varied history of land reform. Most attempts have been just that: attempts without any serious purpose. Table 3.1 gives details of many such attempts, most of which failed. From 1945 onwards there was talk of reform in the nature of tenancy and in the structure of landholding, but little came of it. The reasons for this are fairly clear and not surprising. In the Central Council of the Muslim League in 1947 there was a large representation from the (very) large landlords of the provinces of the Punjab and Sindh—these comprised 50 per cent of councilmen from Punjab and 60 per cent from Sindh. Furthermore, with quite exploitative conditions in rural areas in the 1940s, involving complete domination and control by landlords, it was a little unrealistic to assume that they themselves would be willing to put a dent in their source of power (see Chapter 2, Table 2.2 for landholding patterns in 1947). Landlords were the most significant class in the Muslim League, comprising 163 of the 503 Muslim League parliamentary members in 1942. From the time of independence, all Chief Ministers of the Punjab,

Table 3.1
Key Dates and Features of Land and Tenancy Reforms in Pakistan

Year	Reform	Key features and recommendations
1945	Tenancy Laws Committee, Sindh	Occupancy rights should be granted to *haris* who had personally cultivated at least 4 acres of land annually for the same *zamindar* for 8 years.
1947	*Hari* Committee, Sindh	Defended the landlords; famous Note of Dissent from one member who argued for radical changes in the land tenure system.
1949	Muslim League Agrarian Committee Report	Abolition of *jagirs*; security of tenure for all tenants; share rents should replace rents-in-kind; ceiling on landholdings of 150 acres irrigated and 450 acres for unirrigated; land distribution to tenants and compensation to landlords (report shelved).
1950	Punjab Tenancy Act	No charge by landlords from tenants other than 50 per cent crop share.
1950	Sindh Tenancy Act	Permanent rights of tenancy to long-term tenants; eviction rights to landlords under certain conditions.
1950	Punjab Protection and Restoration of Tenancy Rights Act	Eviction of tenants allowed only under specified conditions.
1952	Punjab Tenancy (Amendment) Act	Abolition of occupancy tenancy; transfer of ownership rights to occupancy tenants; share of landlord reduced from 50 per cent to 40 per cent.
1955	Executive Order	Abolition of *jagirs* and other revenue-free grants; like other *zamindars*, now *jagirdars* required to pay land revenue. Landlordism remained intact, for no limit to ownership as long as all legal dues paid to the government.
1955	Challenge to the Executive Order	Challenge upheld by Sindh High Court.
1959	Land and Tenancy Reforms – Martial Law Regulations 64, 64A and 64B	Ceiling on landholdings: 500 acres irrigated, 1,000 acres unirrigated additional land allowed to bring landholding to equivalent 36,000 PIUs; resumed land to be sold first to tenants and then to small farmers; abolition of *jagirs*; occupancy tenants made owners; all tenants, *haris* and tenants-at-will given legal protection; rents to be paid in kind and all charges other than crop share abolished.
1972	Land and Tenancy Reforms – Martial Law Regulation 115 and amendments	Ceilings on landholdings: 150 acres irrigated, 300 acres unirrigated or equivalent of 12,000 PIUs + 2,000 PIUs for tractor and tube well owners; no compensation to landowners, land redistributed without charge to landless tenants cultivating resumed land; untenanted resumed land redistributed without charge to small owners/tenants with holdings below subsistence; share system remains unchanged; land revenue, water rates, and seed costs borne by landlords and cost of fertilizers and pesticides to be shared equally; tenant eviction decided by revenue courts if tenant failed to pay rent, failed to cultivate land, sublet tenancy, or rendered land unfit for cultivation.
1977	Land Reforms Act	Landholdings: 100 acres irrigated, 200 acres unirrigated or 8,000 PIUs equivalent; compensation to landowners on resumed land at Rs. 30 per PIU; redistribution as in 1972. This Act was completely ignored by the military government after July 1977.

Sources: For 1945 and 1947, Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981). For the rest of the chart, Nabi, Ijaz et al. *The Agrarian Economy of Pakistan: Issues and Policies* (Karachi: Oxford University Press, 1986), 60.

Sindh and NWFP were big landlords. If the power of landlords prior to 1947 was substantial, the creation of Pakistan increased their power even further. Many of them were able to acquire large tracts of land from the fleeing Hindus, while others bought land from moneylenders at cheap rates in the mayhem that ensued. Others, because of their influence in the area, were able to get the revenue officials to sign over land to them, in excess of their due share. Hence, there was little scope for serious reform in agriculture at the time of partition.

The 1949 Muslim League Agrarian Committee proposed some measures that could have addressed the issues related to land, its distribution, and its use. The report was shelved soon after being finalized. The hold of large landlords on political power can be demonstrated by the provincial elections held in the Punjab in 1951, where they won 80 per cent of the seats, while in the provincial election in Sindh in 1953 large landowners won 90 per cent of seats.[30] Mahmood Hasan Khan writes that in the 1950s,

> the landed élite continued to exercise their traditional power without hindrance or opposition in the countryside. In this they were supported by the civilian bureaucracy, as was evidenced by the failure of tenancy reform measures legislated in the Punjab and Sindh. More significantly, as new irrigation and settlement schemes in the Punjab and Sindh were undertaken in the mid-fifties, civil and military bureaucracies were clearly given preferential treatment for irrigated land.[31]

Thus, the nexus of political power between the civil and military bureaucracy and the landlords ensured that the status quo would not be disturbed. As Mahmood Hasan Khan argues,

> it seems fair to conclude that the approach to land reforms depended on the class character of the power élite. As long as landlords occupied a central place in the balance of power, and their position remained without threat in rural areas, no land reforms could have been implemented. The political system created new pressures which the landed elite could not successfully resist.[32]

The first land reforms in Pakistan were undertaken by a military regime that was perceived to be modern and progressive. The Ayub Khan regime did not owe its allegiance to, and nor was it dependent on, the influence of the agrarian landed class, and thus it was in a position to undertake some sort of reform. However, although the reforms set out to break the power of the large landholding class and to make tenancy more humane, their impact was severely limited. What they did was to distribute power away from some landlords and include the civil and military élite in their strategy. While Shahid Javed Burki has implied that these land reforms were the precursor to the dynamic middle-class farmer of the Green Revolution, who emerged as the main beneficiary of the Basic Democracies system, most other scholars disagree (see section 3.1). Hamza Alavi[33] and Mahmood Hasan Khan[34] argue that the Basic Democracies system maintained the hold of the landlord on the political system of Pakistan. Nirmal Sanderatne also argues that the 1959 land reforms were an eyewash, where the power of the ruling coalition of landowners, bureaucrats, and industrialists was left well intact.

3.2.1 The 1959 Land Reforms

Table 3.1 presents the salient features of the Ayub Khan land reforms of 1959. The reforms were meant to put ceilings on landholdings and were supposed to be an attempt to change tenancy regulations.

As we showed in the previous chapter (Table 2.2), before the land reforms of 1959 the distribution of land ownership was highly skewed in favour of a few large landlords who controlled large tracts of land. Approximately 6,000 owners owned more than the ceiling of 500 acres permitted in 1959. They constituted 0.1 per cent of the owners, but owned 7.5 million acres or 15.4 per cent of the total land. Table 3.2 shows that in all there were only 5,064 declarants, of which only 15 per cent or 763 were affected by the ceilings on individual holdings. The area of land owned by the affected declarants was 5.5 million acres, of which only 1.9 million (35 per cent) was resumed. The main portion of their land was retained by the landlords due to numerous provisions made in the law, such as for the transfer of land to dependants and other members of their families, and exemptions for numerous categories.

Not only was a small amount of land handed over, but of that land, more than half (57 per cent) was uncultivated. Of this, parts were hills or deserts—terrain which was not fit for cultivation—and some consisted of land that needed to be developed in order to be made fit for cultivation. Since a central feature of the 1959 land reforms was that owners were to be paid compensation for their lands, many benefited by handing over poor-quality lands to the government. As Mahmood Hasan Khan argues, 'given the high proportion of uncultivated land surrendered in certain districts, it is clear that landowners received payments for land which was producing nothing and most of it would require improvement after it was sold to new owners'.[35] Compensation was paid at rates of Rs. 1–5 per Produce Index Unit (PIU) (see Appendix 3.1) and in 'fifty half-yearly equated instalments in transferable but non-negotiable bonds bearing 4 per cent per annum interest on unpaid balance'.[36]

Another feature of the 1959 reforms was that resumed land was to be sold to landless tenants. By 1967, only 50 per cent of the resumed land had been sold, with only 20 per cent of the resumed land sold to landless tenants. The remainder was auctioned to rich farmers and civil and military officials. According to one estimate, only 67,000 landless tenants and small owners could have bought the resumed land sold to them.[37] The land was sold at the rate of Rs. 8 per PIU, payable in fifty half-yearly instalments with a 4 per cent annual interest rate on the outstanding balance.

Due to the abolition of *jagirs* in 1959, 0.9 million acres were declared as *jagir* lands, of which one-third were resumed by the government. The purpose of the abolition of revenue-free

Table 3.2
Number of Declarants and Resumed Area under the Land Reforms Regulation of 1959

Province/division	Number of declarants			Area of affected declarants (acres)	Area retained (acres)	Area gifted (acres)	Area resumed (acres)
	All	Unaffected	Affected				
Punjab	2,152	1,844	308	3,637,648	2,306,657	288,715	1,044,276
Multan	838	720	118	2,838,325	1,934,664	225,411	672,250
Sargodha	606	504	102	412,213	165,033	28,701	218,479
Rawalpindi	249	227	22	148,827	53,019	9,947	85,861
Lahore	102	85	17	38,813	25,631	4,008	9,176
Bahawalpur	357	308	49	199,470	128,310	12,650	58,510
Sindh	2,388	1,993	395	1,487,253	655,384	169,803	662,066
Khairpur	1,006	870	136	637,029	368,154	67,903	200,972
Hyderabad	1,375	1,117	258	842,872	281,220	101,900	459,752
Karachi	7	6	1	7,352	6,010	–	1,342
Punjab and Sindh	4,540	3,837	703	5,124,901	2,962,041	456,518	1,706,342
Pakistan	5,064	4,301	763	5,478,945	3,077,738	497,419	1,903,788

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), 163.

lands (*jagirs*) was to transform them into revenue-paying tracts. In 1960, the government realized about Rs. 3 million from this provision.[38]

The land reforms allowed farmers to have their lands valued in PIUs, up to a maximum of 36,000 PIUs. The PIU is 'estimated as a measure of the gross value per acre of land by type of soil and was, therefore, seen as a measure of land productivity'.[39] However, the measurement of the PIUs was based on pre-partition revenue settlements, which substantially under-reported the true value of the land. Thus, even if we take the 1959 PIU as the correct measure of productivity, the 36,000 limit was far greater than the allotted ceiling of 500 acres of irrigated land. For example, it has been calculated that in the irrigated areas of Sindh the PIU per acre would have been about 20. This meant that each individual could own at least 1,800 acres according to the law which limited holding to 500 acres.[40] (For a note on PIUs, see Appendix 3.1.).

Mahmood Hasan Khan sums up his evaluation of the reforms as follows:

> It is now evident that the land reforms of 1959 could not have reduced the feudal power of landlords. For one thing, the generous ceiling on individual holdings, with transfers and exemptions, defined as they were in PIUs, left the concentration of land in the hands of landlords. If we accept that the average retained area by the so called affected landlords was the *de facto* ceiling, then its limit was 7,489 acres in the Punjab, 1,659 acres in Sindh, and the average for the country was 4,033 acres. Further, almost three-quarters of resumed land, at least in the Punjab, was uncultivated and untenanted. This meant that the amount of land available for redistribution (and remember by sale) was even more limited. Further, landlord–tenant relations were left unchanged, to be governed by the tenancy acts passed in the early fifties and to be supervised by the revenue service.[41]

3.2.2 The Bhutto Reforms of 1972

The 1972 reforms were different from those of 1959 in many respects. Firstly, the philosophy behind the Bhutto reforms was based on the social democratic leanings of the Pakistan People's Party. In March 1972, Bhutto gave a speech in which he said that his land reforms would 'effectively break up the iniquitous concentrations of landed wealth, reduce income disparities, increase production, reduce unemployment, streamline the administration of land revenue and agricultural taxation, and truly lay down the foundations of a relationship of honour and mutual benefit between the landowner and tenant'.[42] The Manifesto of the People's Party laid the premise for this action by stating that 'the break up of the large estates to destroy the feudal landowners is a national necessity that will have to be carried through by practical measures'.[43]

The main features of the reforms are shown in Table 3.1. A few features distinguished the 1972 reforms from the earlier ones. While ceilings had been further lowered in 1972 and a number of exemptions removed, possibly the most prominent feature of the reforms was that, unlike in 1959, land resumed from landowners would not receive any compensation, and this land was to be distributed free to landless tenants. In addition, all those peasants who had acquired land under the 1959 reforms and had dues outstanding, had their dues written off and were not required to make any further payments.

Of the land declared to be above the ceiling by the landowners, after they had made generous use of the possibilities for getting around the imposition, only 42 per cent was resumed in the Punjab, while the figure in the

Sindh was 59 per cent. In all, 0.6 million acres were resumed, far less than the 1959 figure and constituting only 0.001 per cent of the total farm area in the country.[44]

The problem of the evaluation of the Produce Index Units arose once again. The ceiling of the land was defined both in area and PIUs, and the landowner could retain the larger. However, Mahmood Hasan Khan writes that

> the most serious problem of defining the ceiling in PIUs was that their values had remained unchanged, while almost everything affecting their value had changed drastically in most areas of the Indus Basin. The produce value of an area of land was being grossly underestimated in the Indus Basin, thanks to changes in prices, cropping intensities and patterns, irrigation, etc.[45]

The result was that with 12,000 PIUs one could get away with 400 acres in the Punjab and 480 in Sindh. Moreover, with other exemptions for tube wells and tractors, a family could have retained up to 932 irrigated acres in the Punjab and 1,120 in Sindh![46] (See also Appendix 3.1.)

Although a lot of propaganda was issued about the success of the 1972 reforms, as the resumed land was far less than in 1959, only 50,548 persons benefited from the redistribution of 308,390 acres during 1972–8. Only 1 per cent of the landless tenants and small owners benefited by these measures. Table 3.3 shows that of the land resumed in 1959, 6 per cent still needed to be distributed even after 38 years, and 39 per cent of the area resumed under the 1972 reforms was still held by the government despite the presence of a large number of landless cultivators.

Table 3.3
Progress of Implementation of Land Reforms up to June 1994 (in Hectares)

Province	Area resumed	Area disposed of	Balance	Persons benefiting
1959 reforms				
Punjab	511,244	505,082	6,162	109,889
Sindh	346,307	300,091	46,216	46,131
NWFP	112,108	97,287	14,821	24,314
Balochistan	53,268	53,196	72	6,221
Total	1,022,927	955,656	67,271	186,555
1972 reforms				
Punjab	121,593	94,583	27,010	36,017
Sindh	112,920	72,477	40,442	17,167
NWFP	57,415	55,122	2,293	12,811
Balochistan	189,316	73,755	115,562	5,506
Total	481,244	295,937	185,307	71,501

Source: Government of Pakistan, *Agricultural Statistics, 1993–94* (Islamabad, 1995), 129.

3.3 Summary and Further Reading

3.3.1 Summary

It seems that the technological package that resulted in the Green Revolution in the mid-1960s was focused on the more well-to-do farmers in the more prosperous regions. This is factually correct, but fails to highlight the externalities and other repercussions of this important process. The demonstration effect of using the technological package was substantial, but more importantly, a supposedly simple technological intervention let loose many economic and social processes, resulting in migration, labour displacement, the formation of small towns, skilled labour power, and a host of other political outcomes. Our evaluation of the 1959 and 1972 land reforms, however, shows that they failed to make substantial changes in the landowning structure of the country. Shahid Javed Burki argues that the 1959 reforms created the enterprising middle farmers—a view that is contested by Hamza Alavi, who argues that landlordism became more established and entrenched. Of course, given the hold of the landowning class on government and its institutions, this is not very surprising. The huge loopholes that existed in the 1959 reforms to make intra-family and intra-household transfers meant that the landowning structure remained largely unaltered. Hence, effective land reform in Pakistan will continue to be a problem. Nevertheless, we show in the next two chapters that, even if formal land reforms are not undertaken in Pakistan, other social and economic processes can achieve similar results. Smaller landholdings and more capitalist lines of agricultural production have developed despite a lack of adequate land reform. Demographic and economic changes over the last twenty years have resulted in evolving a different pattern of ownership and production than in the past. While these processes are not a substitute for land reform, it is important to realize their contribution towards achieving somewhat similar ends. However, in Chapter 5 we do make the argument for land reforms.

3.3.2 Further Reading

Amongst the books on the two topics covered in this chapter, the following are recommended:

Khan, Mahmood Hasan, *The Economics of the Green Revolution in Pakistan* (New York: Praeger, 1975); Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981); Robert D Stevens et al. (eds.), *Rural Development in Bangladesh and Pakistan* (Honolulu: University Press of Hawaii, 1976); Ali, Karamat (ed.), *Pakistan: The Political Economy of Rural Development* (Lahore: Vanguard, 1986); Hussain, Akmal, *Strategic Issues in Pakistan's Economic Policy* (Lahore: Progressive Publishers, 1988); Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984); and Ijaz Nabi et al. *The Agrarian Economy of Pakistan: Issues and Policies* (Karachi: Oxford University Press, 1986).

Appendix 3.1

The measurement of Produce Index Units and a case for their revision

M. Shafi Niaz documents the history of Produce Index Units and how they are measured. He makes the strong case for their reappraisal as follows:

Before the partition of the Indian sub-continent, there was an obligation on the part of the governments to periodically carry out revenue assessment of land holdings. This period generally varied between 15 to 20 years. The last assessment that had taken place before partition in the undivided Punjab was in the mid-thirties. The main idea of such assessments was to revise the land revenue in accordance with the changed values of the land. For such valuation, each administrative district was divided into assessment circles. In each such circle, land was categorized whether it was *chahi* (well-irrigated), *chahinehri* (well-cum-canal irrigated), flood irrigated, or *barani* (rain-fed) and so on.

According to the information contained in the Report of the Land Reforms Commission for West Pakistan, 1958–59, the produce value per acre of each class of soil in the various assessment circles was worked out on the basis of average 'matured-acre-yields' and prices adopted by the Settlement Officer at the time of the last settlement of each district. The total produce value thus obtained for each class of soil in each assessment circle was, therefore, divided by the average matured area in order to arrive at the average productive value for one matured acre of land.

The Land Reforms Commission Report further states that for working out a reasonable formula, it was felt by both the governments that since the settlement operations were carried out at different times in different districts, 'suitable' multiples had to be applied to the produce values, as described above, for bringing them to uniform levels in both the Punjab and other agreed areas of India.

For this purpose, a basic period of three years (excluding unusually bad years) was selected for all the districts in both the Punjabs, and average value of the output per acre of sown area in the year in which actual prices corresponded, as far as possible, with the prices assumed by the Settlement Officer were ascertained. This period was called the 'settlement period'. Then the average value of the output per sown acre in this base period was calculated and figures of produce given by the Settlement Officers were multiplied by the ratio which the average value of the produce per acre of the base period, bore to that of the settlement period. This methodology can be explained, by an example of Tehsil Lahore for the assessment circle 'Bet Chahi' having '*chahi*' (irrigated land) as the class of soil. In this case, the total area involved was 10,117 acres having a gross produce value of Rs. 409,104. The produce value for the 'matured' area comes to 40 (gross produce value divided by the total matured area). This is multiplied by 2.0, the worked out ratio for the Lahore district. The resultant figure of 80 is the produce index (or produce index unit) for the assessment circle referred to above.

The agreed formula was adopted by both the governments as a pressing need of the time with a view to settling the refugees without loss of time. It is no denying the fact that the objective in accepting the formula was to try to allot land holdings, as best as possible, of equal value to the immigrants so that they could quickly start to earn their livelihood for the upkeep of their uprooted families.

This formula served the purpose of the day despite the inherent weakness it had. According to the available information, the assessment of land was not carried out on an extensive and comprehensive scale in provinces other than the Punjab. So the exercise in the three provinces had to be carried out in haste so that the rehabilitation process was not held up and to let it go ahead without any undue hindrance. A close reading of the methodology as quoted above, would raise a number of questions about the validity of the produce index units and it would not serve a useful purpose to go into the details here. It is, however, generally believed that in the NWFP and the Punjab, the PIUs were worked out, inter alia, on the basis of 'total' production of land while in Sindh these were worked out on the basis of the shares of the produce which the landlord got and these varied generally between 50–60 per cent of the total produce. A disparity thereby seemed to have developed at the time of the formulation of the PIUs which has its implications at the implementation stage, whenever these were used as a basis for policy decision. The result has been that the farmers in the NWFP and the Punjab were bound to bear the inequalities in the allotment of land at the time of independence and in the future use of PIUs, particularly when a ceiling on individual ownership of land was determined as a result of land reforms in 1958–9, 1972 and 1977. The situation in Balochistan was not much different. The province-wise details are given below.

For the Punjab, as mentioned above, the PIUs were worked out more systematically. The assessment circles, totalling 265, were made the basis, and each assessment circle was divided according to the status of the soil, irrigation facilities and other identical factors. In all, some 1363 areas were categorized. Of these areas, about 600 (or 44 per cent) were those where the PIUs were above 40. If agricultural tax is to be levied on lands having 40 PIUs or more, 40 per cent of the areas would be liable to land tax.

In Sindh, PIUs were worked out by each Taluka (tehsil) and the land in each Taluka (74 in all at that time) was, in general, categorized on the basis of the type of irrigation (flow, lift, combined) available for raising crops. The total number of such categorized areas (as one would call them) amounted to 480. It is very interesting to note that it was only in one out of the 480 areas where the PIUs were 42 and in all other areas these were much less than 40. So, if agricultural tax is to be levied on land having 40 PIUs or more, only one of 480 areas would be liable to tax; other areas should get exemption.

The basis for working out PIUs in the NWFP province is similar to that of the Punjab. The total assessment circles were about 100. These circles were divided into about 480 areas depending mainly on the mode of irrigation facilities,

type of crop grown, and so on. Of these 480 areas, about 200 or 40 per cent have PIUs more than 40. If agricultural tax is levied on land having 40 PIUs or more, about 40 per cent of the areas would be liable to land tax. The PIUs in Balochistan province were prepared only for 4 tehsils divided into 16 assessment circles in which PIUs for 44 types of land were recorded. Only 17 out of these have PIUs above 40 which could be liable to agricultural tax if it is levied on areas having 40 PIUs or more.

The above facts and figures bring out not only the disparity that exists in the methodology used in working out PIUs in the various provinces but also show that these are by now far out-dated and thus unrealistic and unequitable for use either in determining the ceiling on ownership or for using as the basis for land tax. If PIUs have to be used in future for any useful purpose, these must be redetermined. And for this purpose, land assessment may have to be carried out as a prerequisite. Time and effort for the exercise will be well spent and will bring dividends in the form of, amongst other things, upward revision of the land revenue as the value of land must have gone up manifold since last assessment operations were carried many decades ago. This would undoubtedly also help the provincial governments to improve their resource base and all the provinces would get an equitable and uniform basis for future use of PIUs.

Source: Niaz, M. Shafi, *Dawn*, 7 October 1995.

Notes

1. Alavi, Hamza, 'The Rural Elite and Agricultural Development in Pakistan', in Ali, Karamat (ed.), *Pakistan: The Political Economy of Rural Development* (Lahore: Vanguard, 1986), 34.
2. Sanderatne, Nirmal, 'Landowners and Land Reforms in Pakistan', in Ali, Karamat, op. cit., 1986, 306.
3. Ibid. 317.
4. Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981); and Khan, Mahmood Hasan, 'Classes and Agrarian Transition in Pakistan', in Ali, Karamat, op. cit., 1986.
5. Khan, Mahmood Hasan, op. cit., 1986, 446.
6. Sanderatne, Nirmal, op. cit., 1986, 307.
7. Hussain, Akmal, 'Technical Change and Social Polarization in Rural Punjab', in Ali, Karamat, op. cit., 1986, 320.
8. Ibid. 322.
9. Gotsch, Carl H., 'Tractor Mechanization and Rural Development in Pakistan', in Ali, Karamat, op. cit., 1986, 65.
10. Ibid. 65.
11. Ibid. 67.
12. Alavi, Hamza, op. cit., 1986, 37.
13. Ibid. 53.
14. Mahmood, Moazam, 'The Pattern of Adoption of Green Revolution Technology and its Effect on Landholdings in the Punjab', in Ali, Karamat, op. cit., 1986, 191.
15. Khan, Mahmood Hasan, op. cit., 1986, 447.
16. Burki, Shahid Javed, 'The Development of Pakistan's Agriculture: An Interdisciplinary Explanation', in Stevens, Robert D et al. (eds.), *Rural Development in Bangladesh and Pakistan* (Honolulu: University Press of Hawaii, 1976), 308.
17. Alavi, Hamza, op. cit., 1986, 21.
18. Hussain, Akmal, 'Land Reforms in Pakistan', in Hussain, Akmal, *Strategic Issues in Pakistan's Economic Policy* (Lahore: Progressive Publishers, 1988), 178.
19. Burki, Shahid Javed, op. cit., 1976.
20. Alavi, Hamza, op. cit., 1986; Hussain, Akmal, op. cit., 1986.
21. Alavi, Hamza, op. cit., 1986, 44.
22. Ibid. 31.
23. Khan, Mahmood Hasan, op. cit., 1981, 44.
24. Sanderatne, Nirmal, op. cit., 309.
25. Ibid. 309.
26. Alavi, Hamza, op. cit., 55.
27. Hussain, Akmal, op. cit., 187.
28. Ibid. 188.
29. This section is drawn from Khan, Mahmood Hasan, op. cit. 1981; Sanderatne, Nirmal, op. cit.; and Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984).
30. Khan, Mahmood Hasan, op. cit., 1981, 147.
31. Ibid. 143.
32. Ibid. 150.
33. Alavi, Hamza, op. cit.
34. Khan, Mahmood Hasan, op. cit.; 1981.
35. Khan, Mahmood Hasan, op. cit., 1981, 164.
36. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 124.
37. Khan, Mahmood Hasan, op. cit., 1981, 166. This figure differs from that in Table 3.3 as it is much older and is probably calculated differently.
38. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 121.
39. Hussain, Akmal, op. cit., 1988, 180.
40. Khan, Mahmood Hasan, op. cit., 1981, 159.
41. Ibid. 166–7.
42. Sanderatne, Nirmal, op. cit., 1986, 309.
43. Khan, Mahmood Hasan, op. cit., 1981, 171.
44. Hussain, Akmal, op. cit., 1988, 182.
45. Khan, Mahmood Hasan, op. cit., 1981, 176.
46. Ibid. 177.

4 The Nature and Direction of Agrarian Change

We have established the premise in the previous chapter that capitalism in agriculture began to establish itself early in the twentieth century following a number of interventions made by the British colonialists in the region that now constitutes Pakistan. The feudal or pre-capitalist structures, while prevalent, were slowly being dismantled and dissolved. Pre-capitalist forms have shown a resilience in many parts of the world despite the development of capitalism. Notably, peasant forms of farming which should have been dissolved under capitalism, where two classes of owners are supposed to emerge and coexist, have shown persistence against all odds. Nevertheless, in Pakistan it would be fair to say that once capitalism took root in agriculture, it began to eliminate pre-capitalist and feudal modes. Once established, capitalism became the dominant mode of production in agriculture and throughout the entire economy, although pre-capitalist forms continue to be resilient and persist.

These, in many ways, are the most important themes in relation to agriculture: to examine how and why Pakistan's agricultural sector has been developing in a particular direction, and to assess what possible direction it will take. Agrarian transition or change, by definition, implies movement from one place or type to another. How have economic and social relationships changed over time in agriculture? Have there been significant changes in landholding and landownership patterns? What has been the trend of sharecropping—is it on the rise, or falling? These are some of the questions that this chapter will discuss. We will also see the different patterns in the four provinces, and especially in the Punjab and Sindh, which form the backbone of Pakistan's economy and politics. Our main focus in this chapter will be on the change in agrarian structure and agrarian relations from the 1960s to the present.

The chapter contains numerous tables, which are extensive and cumbersome. However, these numbers are essential, for we can base our analysis only on the observation and interpretation of data. While making the tables available for those interested in examining the precise figures; we attempt to describe and summarize their salient features before discussing and interpreting them.

Things are further complicated by the problem of how one should classify and categorize the pattern of landownership and other phenomena that we want to observe. However, we may not always be able to choose the categorization that we want, as data limitations—severe at times—may force us to accept and use only what is already available. For example, we may prefer to use the concept of *classes* to explain agricultural processes and change, and to show which class constitutes what share in the agricultural sector as landowners and as producers of labour power. The use of class helps us to observe important trends in the types of change taking place. For example, how is the process of capitalism being consolidated over time? Can one identify feudal remnants, and what has been their contribution over time? However, while we would like to use the concept of class to study agrarian transition, data of this nature are not easily obtained. Despite its numerous shortcomings we must make use of what is published (see Appendix-4.1).

What is published by the Government of Pakistan regarding agricultural landholding patterns is usually based on the nature of tenure: 'owners', 'owner-cum-tenants', and 'tenants'. Moreover, size usually plays an important role in the classification, where either small/medium/large is used, or some distribution by the size of holding, i.e. acreage categories, is made available. However, Mahmood Hasan Khan correctly points out that 'the concept of farm size by its very nature is quite arbitrary and therefore not universal. Secondly, division of farms into small and large does not reveal anything about who controls and cultivates these farms.'[1] Although there are problems with this sort of classification, we use these criteria in the tables that follow—not only because of the absence of alternative data, but also because they still offer useful insights into the nature and direction of change in Pakistani agriculture.

4.1 Explaining the Numbers

In this section we attempt to highlight the main features of the tables provided. The explanations given here are important in following the arguments in a later section. Those who can grasp the numbers and their meaning easily are advised to read the text and then explore further details in the tables.

There have been six agricultural censuses in Pakistan, in 1960, 1972, 1980, 1990, 2000, and 2010. Our method of presentation and explanation takes the following pattern. For each of the census years, we will highlight, separately, the main features in the relevant table. We will try to standardize the format as far as possible so that the trends can be followed, although, this is easier said than done. After presenting a summary of each census, we present some tables which compare the trends over time, describing the salient features. In the next section, we try to interpret these tables and examine their implications.

The 1972 Census (Table 4.3)

1. By 1972, owner farms had replaced tenant farms as the largest category in terms of both number (42 per cent) and acreage (40 per cent) in Pakistan (Block A, columns III and IV). In fact, the shift in both tenant farms and owner farms in the period 1960 to 1972 is quite significant (compare Block A, columns VII and VIII in Tables 4.2 and 4.3; also compare Block A, columns III and IV in the two tables). Owner-cum-tenant farms remained the smallest category. In Sindh, tenant farms now comprised 63 per cent of farms with 51 per cent of the area (Block A, columns VII and VIII). In the Punjab, owner farms dominate in both number and area, and their proportion in each category is almost identical to the 1960 situation (compare Block A, columns III and IV in Tables 4.2 and 4.3 for the Punjab).
2. In the less than 5-acre category, Block B, now only 28 per cent of all of Pakistan's farms number can be observed (column I) with 5 per cent of total cultivated area. In the more than 150 acres category (Block G, columns I and II), 0.43 per cent of farms own 9.1 per cent of cultivated land.
3. The proportion of owner farms in the less than 5-acre category (Block B) has fallen to 41 per cent (column III) compared to 60 per cent in 1960, with a severe cut in the tenant farms category (Block B, column VII), which fell from 46 per cent in 1960 to only 22 per cent in 1972.
4. The owner-operated area in both provinces has increased somewhat over the period 1960–72.

The 1980 Census (Table 4.4)

1. Owner farms now constitute a simple majority in both number and area in Pakistan (55 and 52 per cent, respectively), and in the Punjab (54 and 50 per cent, respectively) (Block A, columns III and IV). In Sindh, tenant farms are the largest in number (49 per cent of all farms) (column VII), but owner farms have access to 47 per cent of total cultivated area in the province (column IV).
2. Thirty-four per cent of the number of farms in Pakistan are in the less than 5-acre category, and own 7 per cent of the land (Block B, columns I and II). Less than half a per cent, 0.34 per cent of the farms in Pakistan, own 8.5 per cent of the land (Block G, columns I and II).
3. Forty-two per cent of owner farms in the Punjab are less than 5 acres (Block B, column III), while of all tenant farms, almost half are in the 5–12.5-acre category (Block C, column VII). In Sindh, the largest number of farms (50 per cent) are in the 5–12.5-acre range, as they are in the Punjab (39 per cent) (Block C, column I).
4. Owner-operated farms are the predominant form in both provinces: 64 per cent in the Punjab, and 55 per cent in Sindh (Block A, column IX).

The 1990, 2000, and 2010 Census (Table 4.5)

The summary data available from the 1990 census shows that 47 per cent of farms in Pakistan were in the under 5-acre category and they owned 11 per cent of the farm area, while 0.3 per cent own more than 150 acres with access to 10 per cent of acreage.

Much of the trend we have seen since 1972, continues unabated across the last four decades. In fact, one can see a clear difference in many categories from Table 4.5, even over one decade, that of the 1990s. Some key features of the 2000 census reveal, that there is a more or less consistent fall in the average size of farms, that a majority of farms in Pakistan, especially in the Punjab and Khyber Pakhtunkhwa, are in the under 5-acre category, although the average size of holding in this category has fallen to what it was in the past. On the higher side as well on farms which are above 150 acres, one sees from Table 4.5, that while the number of farms has fallen, the average acreage has increased considerably. In fact, as Table 4.5 shows, between 1990, 2000, and 2010, the average size of farm has fallen in almost every single category except for the largest category suggesting greater consolidation of land holdings.

4.1.2 Changes Over Time

Having looked at some of the main characteristics in each of the census years, we should now turn our attention to what has happened over time and see how certain categories have shifted in importance. Let us turn to Tables 4.6 to 4.9.

Table 4.6 shows the *number of farms* with tenure classification across the four provinces. It shows how the shares of each tenure type have changed since 1960, and the share of farms in each province. Some highlights:

1. Owner farms increased from 41.1 per cent in 1960 to 68.8 per cent in 1990, to a further 81.8 per cent in 2010, for the whole country. Today, they dominate in each of the four provinces. Tenant farms fell in number from 41.7 per cent of the total in 1960 to 18.7 in 1990, falling further to 11 per cent in 2010.
2. In 1960, 69.6 per cent of farms in Sindh were tenant farms; in 2010, they constituted less than half what they were, at 25.7 per cent. Owner farms have increased substantially in these four decades in the Punjab (from 42.8 to 69.5 per cent in 1990, rising further to 82.4 per cent in 2010), as well as in Sindh (21.6 per cent to 70.3 per cent in 2010).
3. Punjab had more than 68 per cent of all Pakistan's farms in 1960, which fell to 58 per cent in 1990, but has increased its share to 63.5 per cent in 2010. The largest rise has been in the NWFP's share, which was 13.9 per cent of the number of farms in all of Pakistan in 1960, but rose to 21.1 per cent by 1990, to fall to 18.6 per cent in 2010, overtaking Sindh.
4. The share of tenant farms has seen a consistent downward trend, just as owner farms have shown a consistent upward trend over the six decades. Owner-cum-tenant farms have always been the smallest category, but showed a substantial rise during the 1960s, after which they have shown a rapid downward trend.
5. Since we are here looking at the change in the *number* of farms across the four decades, we can return to Tables 4.2

to 4.5, and observe that the marginal (under 5 acres) and small (5–12.5 acres) farms continued to dominate in the Punjab in 2010 as they had in 1960, and their share has risen from 79 per cent of all farms in 1960, to 90 per cent in 2010. Moreover, the pattern has been uneven; the share of 79 per cent in 1960 was followed by a sharp fall in 1972 to only 65 per cent, rising to 71 per cent in 1980, falling again to 68 per cent in 1990, rising once again. In Sindh, the distribution was as follows: 45 per cent in 1960, 70 per cent in 1972, 75 per cent in 1980, 80 per cent in 1990, with a slight rise in 2010. The patterns in the two provinces have followed a diametrically opposite trend, except in the 1972–80 period. The area of these groups, under 12.5 acres, as a proportion of total acreage in the Punjab in the six censuses has been 36, 30, 33, 40, 47, and most recently 58 per cent. In Sindh the acreage owned by these small farms was 27 per cent in 1960, 38 per cent in 1972 and 42 per cent in both 1980 and 1990, 40 per cent in 2000, but fell to 38 per cent in 2010.

Just as Table 4.6 showed the trend in the tenure and total number of farms, Table 4.7 shows the same tenure categories with *farm area*. Some features:

1. Like the number of farms, the area farmed fell consistently and systematically for the tenant farmer between 1960 and 1990, from 39.2 per cent to 16.1 per cent, to fall further to 11.1 per cent in 2010. Not surprisingly, in a mirror-image process, the farmed area of owner farms has risen considerably, most notably in Khyber Pakhtunkhwa. By 1990 owner farms dominated, by far, the total area farmed in all the provinces. Owner farms used to farm 38.3 per cent of total farm area in 1960; by 1990, this had risen to 64.9 per cent of total farm area rising further, to 73.3 per cent in 2000, and 74.5 per cent in 2010.
2. While owner-cum-tenant farms are fewer in number than tenant farms, they have considerably more land to farm than do tenant farms in the Punjab and NWFP.
3. Sindh, which used to have such a dominance of tenant farms (see Table 4.2) has seen a halving of the area farmed by tenants from 5.487 million acres in 1960, to 2.466 million in 1990, down further to 1.838 million acres in 2000. In all the four provinces, the area of tenant farms has fallen quite drastically. In Sindh, tenant farms constitute 26 per cent of all farms, but have access to only 13.1 per cent of the farm area.
4. Of the total farm area in the country, Punjab continues to hold the majority, but Balochistan has made considerable progress in increasing its farm area and in 2010 constituted 15.4 per cent of the total farm area of the country.
5. The total farm area in Pakistan fell from a high in 1972, in 1980 and 1990, but has increased marginally in 2000. Sindh and Balochistan have increased land on which farming takes place. Punjab has lost as much as 4 million acres since 1972.

Table 4.8 takes the data from Tables 4.6 and 4.7 and builds a series showing trends since 1960. The base year is taken to be 2000 = 100, and changes for each of the four provinces in the six censuses can easily be identified.

1. In the table, we see that in 1972 the index for the total number of farms fell in the NWFP and the Punjab, rising thereafter. The number of farms declined in the Punjab, but rose substantially in all provinces after 1980.
2. There has been a huge upward movement in owner farms and an equally impressive downward movement in the number of tenant farms although between 2000 and 2010 there has been a 7 per cent rise of such farms in the Punjab. Owner-cum-tenant farms, after rising, have fallen again.
3. With respect to farm area, owner farms have shown large increases, as tenant farms have lost considerable area. Owner-cum-tenant farms, after increasing their farm area in 1972, continued to lose area in 1980, 2000, and 2010.

Table 4.9 shows how the average farm area has changed over time. We see that the area under 5 acres went up over time in the Punjab, but has fallen between 1990 and 2010, It has also fallen in the 5–12.5-acre category in both Sindh and the Punjab. In the larger categories, between 50–150 acres, it fell a great deal in both the Punjab and Sindh between 1960 and 1990. In the extra-large category, after falling appreciably in 1972, presumably due to the land reforms of the Bhutto government, it rose again and more or less stabilized, but fell again in the 1990–2000 decade, although has risen sharply in the Punjab since.

4.2 What Do the Numbers Mean?

The overall nature of transition in agriculture can best be captured by Figure 4.1. While the three systems of agriculture—peasant, capitalist and feudal—can and do coexist, the trend has been for feudalism to give way to capitalism, which emerges and consolidates itself, while a peasant system is able to survive its onslaught. Figure 4.1 shows these changes with particular reference to Pakistan, where both the feudal and peasant systems are feeding the capitalist system within and outside agriculture (see also Appendix 4.2).

Possibly the single most important feature of the transition in agriculture depicted by the tables in this chapter is the marked fall in tenancy. Tenant farms have fallen sharply in both number and acreage across all sizes of holding in Pakistan. At the same time, there has been an impressive increase in owner farms and the area that they farm. In addition, the owner-operated area has shown a substantial increase in the 5–50-acre groups.

In the category of small farms that are less than 5 acres, we see a large decrease in their number and area between 1960 and 1972, but a considerable rise in both during 1972–80 and 1980–2000. The fall in tenancy between 1960 and 1972 is reflected in the large decrease in the number and area farmed. The later rise in both is not reflected by an equivalent rise in tenancy. There has been a large rise in the number of owners in the small category.

4.1.1 Data from the Censuses

The 1960 Census (Table 4.2)

Table 4.1, which appeared in Chapter 2 and is repeated here, presents some basic data about landholding in the 1950s, and is a good starting point for our discussion.

The main feature of Table 4.1 is that ownership was highly concentrated: 64.4 per cent of the owners owned 15.3 per cent of land, while the 6,061 owners (0.1 per cent) with very large landholdings, owned more (15.4 per cent). In Sindh, land ownership was even more skewed, with 29.1 per cent of land owned by a little over 3,000 people. In the Punjab, fewer than 2,000 owners owned 2.78 million acres, or about 10 per cent of the total area. In Sindh, the 8 per cent of owners who had holdings above 100 acres owned 54 per cent of the total land in the province. Thus, it seems that while both provinces had a highly differentiated structure of land ownership, Sindh was far more inequitable than the Punjab.

For the 1960s, we can make the following observations from Table 4.2:

1. Block A shows that in Pakistan tenant farms were the largest in both number (column VII, 42 per cent) and acreage (column VIII, 39 per cent). Owner-cum-tenant farms were the smallest of the three categories on both counts (columns V and VI, only 17 and 23 per cent, respectively). In Sindh, almost half (49 per cent) of the farms were tenant farms (column VII), which were 56 per cent in terms of acreage of the total area cultivated (column VIII). In the Punjab, owner farms had both the largest number (43 per cent, column III) and the largest area (38 per cent, column IV). We thus see a very different pattern of ownership and tenure in the two provinces in the 1960s, with more owner-operated farms in the Punjab, and greater tenant or sharecropper farms in Sindh.
2. In Pakistan, 49 per cent of all farms were in the under 5-acre category (Block B, column I). However, these 49 per cent had access to only 9 per cent of land. At the other extreme, those with more than 150 acres constituted only 0.29 per cent of owners, but owned 10 per cent of the total land (Block G). More than half of the total acreage in both Sindh and the Punjab is in the two categories which constitute the 5–25 acre group (Blocks C and D), with 54 per cent in the Punjab and 51 per cent in Sindh between 5 and 25 acres.
3. Of all the owner farms in the Punjab, 61 per cent lie in the under 5-acre category (Block B, column III), while in the 'tenants' category, half the farms in the Punjab are less than 5 acres (column VII). In Sindh, since only 18 per cent of all farms are less than 5 acres (Block B, column I), the three categories columns III to VIII constitute a very small fraction of the under 5-acre category.
4. The owner-operated area constitutes more than 50 per cent in the Punjab and only 37 per cent in Sindh (Block A, column IX). Tenant farming was far greater in Sindh than in the Punjab (Block A, columns VII and VIII).

Table 4.1
Distribution of Land Ownership in Pakistan and Provinces: 1950–55

Farm size (acres)	Pakistan		Punjab		Sindh	
	Number of owners	Area owned (acres)	Number of owners	Area owned (acres)	Number of owners	Area owned (acres)
All sizes	5,068,376 (100.0)	48,642,530 (100.0)	3,555,457 (100.0)	28,309,744 (100.0)	337,665 (100.0)	10,285,021 (100.0)
5 or less	3,266,137 (64.4)	7,425,614 (15.3)	2,358,119 (66.3)	4,438,517 (15.7)	100,601 (29.8)	365,817 (3.6)
5–25	1,452,421 (28.7)	15,438,138 (31.7)	1,029,108 (28.9)	11,041,708 (39.0)	155,163 (46.0)	1,937,073 (18.8)
25–100	286,470 (5.7)	10,616,308 (21.8)	146,893 (4.1)	6,198,128 (21.9)	54,792 (16.2)	2,390,358 (23.2)
100–500	57,287 (1.1)	7,671,537 (15.8)	19,401 (0.6)	3,842,986 (13.6)	24,064 (7.1)	2,600,123 (25.3)
500 and above	6,061 (0.1)	7,490,933 (15.4)	1,936 (0.1)	2,788,405 (9.9)	3,045 (0.9)	2,991,650 (29.1)

Note: The data for the Punjab are for 1954/5; for Sindh for 1946/7. The data for Pakistan are the aggregate figures for all provinces. The Punjab includes the former State of Bahawalpur, and Sindh includes the former State of Khairpur.

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), 68.

Table 4.2
Distribution of the Operational Holdings by Size and Tenure in Pakistan: 1960 (in '000 farms and acres)

	Farm size (acres)	All farms		Owner farms		Owner-cum-tenant farms		Tenant farms		Owner-operated area	Tenant-operated area			
		Number	Acres	Number	Acres	Number	Acres	Number	Acres		Total	Share cropped	Leased or rented	Others
		I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIII
A	**All sizes** Pakistan	4,860 (100%) (100%)	48,930 (100%) (100%)	1,998 (41%) (100%)	18,723 (36%) (100%)	834 (17%) (100%)	11,012 (23%) (100%)	2,028 (42%) (100%)	19,195 (39%) (100%)	24,595 (50%) (100%)	23,971 (100%)	21,271 (100%)	1,941 (100%)	759 (100%)
	Punjab	3,326 (100%) (100%)	29,214 (100%) (100%)	1,422 (43%) (100%)	11,169 (38%) (100%)	623 (19%) (100%)	7,180 (25%) (100%)	1,282 (39%) (100%)	10,665 (37%) (100%)	15,252 (52%) (100%)	13,961 (100%)	12,114 (100%)	1,319 (100%)	528 (100%)
	Sindh	979 (100%) (100%)	9,698 (100%) (100%)	137 (14%) (100%)	2,819 (29%) (100%)	60 (6%) (100%)	1,411 (15%) (100%)	483 (49%) (100%)	5,468 (56%) (100%)	3,559 (37%) (100%)	9,136 (100%)	5,864 (100%)	232 (100%)	40 (100%)
B	**Under 5.0** Pakistan	2,404 (100%) (49%)	4,591 (100%) (9%)	1,203 (50%) (60%)	2,014 (44%) (11%)	276 (11%) (33%)	716 (16%) (7%)	925 (36%) (46%)	1,861 (41%) (10%)	2,406 (52%) (10%)	2,185 (9%)	1,903 (9%)	175 (9%)	106 (14%)
	Punjab	1,717 (100%) (52%)	3,129 (100%) (11%)	866 (50%) (61%)	1,452 (45%) (13%)	208 (12%) (33%)	547 (17%) (8%)	644 (38%) (50%)	1,193 (37%) (11%)	1,752 (55%) (11%)	1,440 (10%)	1,266 (10%)	114 (9%)	60 (11%)
	Sindh	174 (100%) (18%)	529 (100%) (5%)	38 (22%) (28%)	106 (20%) (4%)	5 (3%) (8%)	18 (3%) (1%)	130 (75%) (27%)	405 (77%) (7%)	113 (21%) (3%)	414 (7%)	402 (7%)	10 (4%)	2 (5%)
C	**5.0–12.5** Pakistan	1,340 (100%) (28%)	10,903 (100%) (22%)	434 (32%) (22%)	3,468 (32%) (19%)	293 (22%) (35%)	2,414 (22%) (22%)	613 (46%) (30%)	5,020 (46%) (26%)	4,784 (44%) (19%)	6,119 (26%)	5,383 (25%)	571 (29%)	165 (22%)
	Punjab	894 (100%) (27%)	7,281 (100%) (25%)	313 (35%) (22%)	2,505 (34%) (22%)	231 (26%) (37%)	1,903 (26%) (27%)	350 (39%) (27%)	2,873 (39%) (26%)	3,552 (49%) (23%)	3,729 (27%)	3,199 (26%)	419 (32%)	110 (21%)
	Sindh	265 (100%) (27%)	2,180 (100%) (22%)	44 (17%) (32%)	360 (17%) (13%)	18 (7%) (30%)	157 (7%) (11%)	203 (77%) (42%)	1,663 (76%) (30%)	432 (20%) (12%)	1,747 (28%)	1,696 (29%)	42 (18%)	9 (23%)
D	**12.5–25.0** Pakistan	729 (100%) (15%)	12,533 (100%) (26%)	220 (30%) (11%)	3,747 (30%) (20%)	169 (23%) (20%)	2,922 (23%) (27%)	340 (47%) (17%)	5,864 (47%) (31%)	5,323 (42%) (22%)	7,210 (30%)	6,480 (30%)	549 (28%)	182 (24%)
	Punjab	488 (100%) (15%)	8,326 (100%) (29%)	160 (33%) (11%)	2,686 (32%) (24%)	127 (26%) (20%)	2,176 (26%) (30%)	202 (41%) (16%)	3,464 (42%) (32%)	3,877 (47%) (25%)	4,448 (32%)	3,908 (32%)	403 (31%)	137 (26%)
	Sindh	159 (100%) (16%)	2,776 (100%) (29%)	28 (18%) (20%)	505 (18%) (18%)	19 (12%) (32%)	336 (12%) (24%)	112 (70%) (23%)	1,935 (70%) (35%)	666 (24%) (19%)	2,111 (34%)	2,041 (35%)	58 (25%)	12 (30%)
E	**25.0–50.0** Pakistan	286 (100%) (6%)	9,468 (100%) (19%)	94 (33%) (5%)	3,114 (33%) (17%)	71 (25%) (9%)	2,382 (25%) (22%)	121 (42%) (6%)	3,972 (42%) (21%)	4,417 (47%) (18%)	5,051 (21%)	4,570 (21%)	345 (18%)	136 (18%)
	Punjab	180 (100%) (5%)	5,903 (100%) (20%)	61 (34%) (4%)	1,990 (34%) (18%)	46 (26%) (7%)	1,529 (26%) (21%)	74 (41%) (6%)	2,384 (40%) (22%)	2,853 (48%) (19%)	3,049 (22%)	2,695 (22%)	255 (19%)	100 (19%)
	Sindh	61 (100%) (6%)	2,044 (100%) (21%)	16 (26%) (12%)	548 (27%) (19%)	12 (20%) (20%)	407 (20%) (29%)	33 (54%) (7%)	1,089 (53%) (20%)	753 (37%) (21%)	1,291 (21%)	1,233 (12%)	50 (22%)	9 (23%)
F	**50.0–150.0** Pakistan	88 (100%) (2%)	6,539 (100%) (13%)	39 (44%) (2%)	3,009 (46%) (16%)	23 (26%) (3%)	1,693 (26%) (15%)	26 (30%) (1%)	1,837 (28%) (10%)	4,007 (61%) (16%)	2,532 (11%)	2,251 (11%)	185 (10%)	96 (13%)
	Punjab	42 (100%) (1%)	4,230 (100%) (14%)	19 (45%) (1%)	1,459 (34%) (13%)	11 (26%) (2%)	788 (19%) (11%)	12 (29%) (0.9%)	839 (20%) (8%)	1,961 (46%) (13%)	1,125 (8%)	955 (8%)	104 (8%)	64 (12%)
	Sindh	18 (100%) (2%)	3,087 (100%) (32%)	9 (50%) (7%)	677 (22%) (24%)	5 (28%) (8%)	398 (13%) (28%)	4 (22%) (0.8%)	297 (10%) (5%)	904 (29%) (25%)	488 (8%)	419 (7%)	44 (19%)	5 (13%)
G	**150.0 and over** Pakistan	14 (100%) (0.29%)	4,896 (100%) (10%)	9 (64%) (0.45%)	3,372 (69%) (18%)	3 (21%) (0.36%)	884 (18%) (8.03%)	2 (14%) (0.10%)	640 (13%) (3%)	4,023 (82%) (16%)	874 (4%)	684 (3.22%)	115 (5.9%)	75 (10%)
	Punjab	5 (100%) (0.15%)	1,426 (100%) (4.88%)	3 (60%) (0.21%)	1,078 (76%) (10%)	1 (20%) (0.16%)	237 (17%) (3.30%)	0 (8%) (0.03%)	111 (8%) (1%)	1,256 (86%) (8%)	170 (1%)	91 (0.75%)	25 (5.90%)	54 (10%)
	Sindh	2 (100%) (0.20%)	797 (100%) (8.22%)	2 (100%) (1.46%)	623 (78%) (22%)	0 (20%) (0.67%)	95 (12%) (6.73%)	0 (15%) (0.06%)	79 (10%) (1%)	692 (87%) (19%)	105 (2%)	72 (1.23%)	29 (1.250%)	4 (10%)

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981).

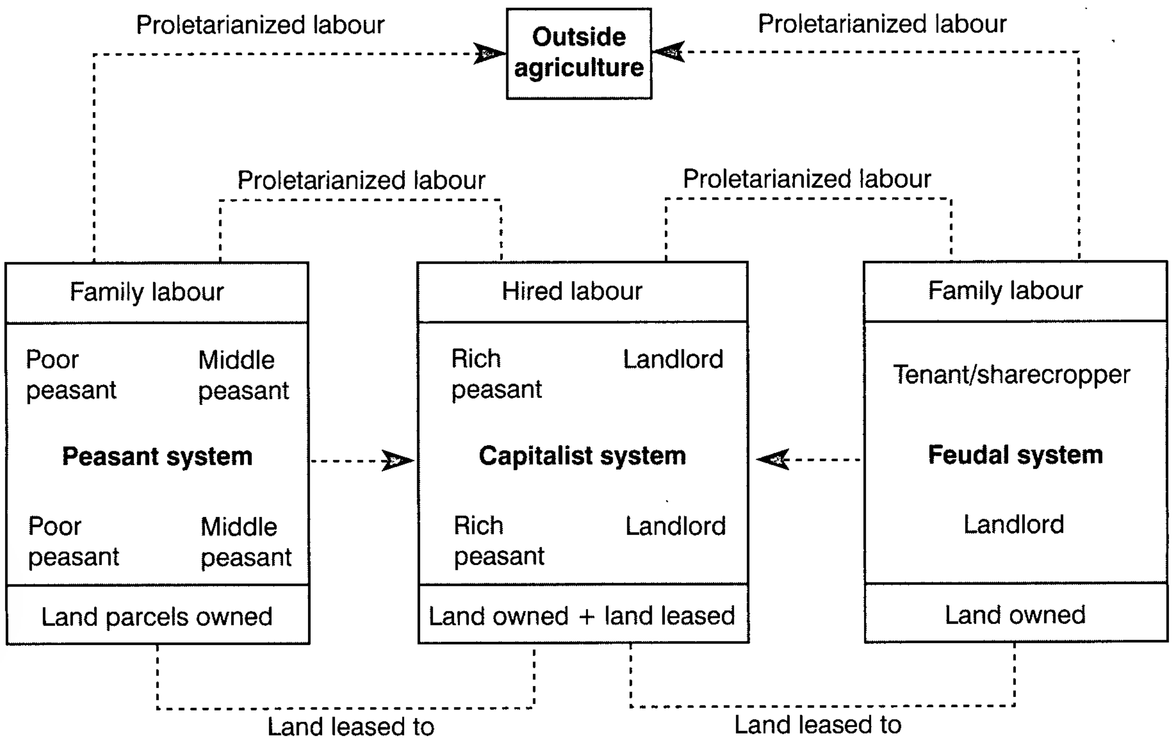


Figure 4.1
Agrarian Transition in Pakistan

Source: Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985), 17.

The category of 5–12.5-acre farms shows a consistent, and sometimes large, increase in all the inter-census periods. The growth of this category is probably the result of the fall in the number and area farmed in both the 12.5–25 and 25–50-acre groups during the period 1972–80. Both size categories, medium and large, lost a number of farms and a large chunk of their area during the 1970s. Between 1980 and 1990, the small category grew in number, although there was a small drop in the area owned and farmed. There was a continuous fall in the number of farms and area owned in both the medium and large categories in both Sindh and the Punjab between 1980 and 1990.

The category of very large 50–150-acre farms remained more or less the same in Sindh between 1980 and 1990, but continued to fall in the Punjab in this period, as it did in the 1972–80 period. In the category of extra-large farms, 150 acres and above, there was a sharp increase in both the number of farms and their area in Sindh between 1980 and 1990 with a small decrease in the Punjab in the same period. However, as Table 4.9 shows average farm size has fallen again in both Sindh and the Punjab, although there has been a marked increase in the average size of operational holding in the 150-and-over category in the Punjab.

The increase in owners and the decline in tenancy suggests that more and more landowners are acquiring land from tenants and are going in for self-cultivation, probably hiring in agricultural wage labour. It is unlikely that many of the tenants are in a position to become owners, so most of them will probably have been changed into agricultural or rural wage labourers or have migrated to urban areas and towns as they have been displaced by owner-cultivators. The dramatic increase in the area farmed by owners over the last four decades may indicate that tenants have been displaced and land brought under self-cultivation, or that many owners have bought land from other landowners. The tables show that the number of farms in the Punjab increased by about the same proportion as the increase in farm area. In Sindh, the number of owners increased much faster than the increase in farm area between 1960 and 1990. However, over this period there has not been a very sharp decline in agricultural employment: the proportion of those employed in agriculture fell from 60 per cent of the labour force to 45 per cent in 2012. It is likely that more sharecroppers and tenants have become agricultural wage workers than have migrated. This implies greater marginalization.

The growth in small farms at the expense of the medium and large farms may be due to greater fragmentation of landholding caused by inheritance, where many heirs may become owners of a single property which was hitherto of a larger size. Moreover, as we argue in other chapters, urbanization has also had a significant impact on land use in so called agricultural areas.

In the Punjab, there was a fall in farm sizes 12.5–25 acres, 25–50 acres and 50–150 acres between 1980 and 1990, and a rise in the number of farms in the 5–12.5-acre category, but with a small fall in area owned, causing the average size to fall. In Sindh, there has been a fall in the categories 5–12.5, 12.5–25, and 25–50 acres, with more or less no change in the 50–150-acre category. This seems to suggest that there is some consolidation of holding taking place on the high side (above 50 acres) in Sindh, with the hold of the extra-large Pakistani landowner (over 150 acres) slipping. However, the most notable phenomenon is the consistent rise of the small farm.

The method we have been using to discuss the nature and direction of agrarian transition very clearly reveals how insufficient and handicapped it is. If we had access to data based on class, or more elaborate data as depicted in Appendix–4.1, we might have been able to get a better handle on the nature of change. Had we known about the relations of production, whether labour was hired or land rented in, we would have been in a position to elaborate on the nature of *capitalist* development and how *capitalist* relations have been further developed. At the moment, we can see that more small farms are being created and many more owner-farms are emerging. However, we do not know how, and under what types of relations of production, these self-cultivators produce. It would be reasonable to assume that they are either family farmers or peasants who, in all likelihood, hire in labour. At the other end of the spectrum, the increase in the extra-large category suggests that these are capitalist farmers who have resumed their land from sharecroppers and probably hire in a large number of agricultural wage labourers. It is also possible that these large landholders have bought land from the medium and large farmers of between 12.5 and 50 acres, who have found it less profitable to farm as competition has increased further.

Mahmood Hasan Khan, who has differentiated the data based not only on size of holding, but also on the categories shown in Appendix 4.1, has been able to show us a clearer picture of the nature of the agrarian transition.[2] He looks at data pertaining to land rented in and rented out by various sizes of farms in the 1970s and finds that 'farmers owning 5 acres or less were renting their area out but the area so rented out also increased substantially in the seventies. . . . Owners of middle-sized farms 5–25 acres in the Punjab rented out land but in Sindh they rented in from others.'[3] This, he argues, is due to the very different nature of production in the two provinces: the middle-sized farmer in the Punjab is of the capitalist type of family farmer, while in Sindh this farmer employs sharecroppers. Furthermore, he says that in the Punjab the middle and poor peasants lease out increasing amounts of their land to others, while in Sindh sharecroppers rent in land from landlords. He also has evidence which supports our contention above, that in Sindh there was 'a shift towards capitalist farming through increased resumption of land by landlords from sharecroppers for cultivation by their own selves',[4] which is one reason why the size of farm has increased over the years in the extra-large category of over 150 acres. For Mahmood Hasan Khan, capitalist farmers are increasing in the Punjab and Sindh 'at the expense of poor and even middle class peasants in the former and against landlords and their sharecroppers in Sind'.[5] Elsewhere he argues that 'capitalist farming is . . . facilitated by the increased size of operational holding (farm)'.[6]

Finally, Table 4.10 shows quite dramatically how a number of important changes took place between 1960 and 1980. It would have been even more interesting to see the changes from the 2010 census, but data are not available in this form. Nevertheless, the table only amplifies and endorses the analysis presented above. It shows the following:

1. The number of pure owner farms increased considerably, as did their share of area, but not by as much.
2. Pure tenant farms were far fewer in 1980 than in 1960; their area also fell markedly, although their average size seems to have increased marginally.
3. Sharecropping also saw a very marked decline in this period, although some 'pure' tenant farms may have become owner-cum-tenant farms.
4. Overall, the total number of farms fell and so did the total farm area, but at a slower pace, resulting in an increase in the average farm size.

Although data in this form is not readily available, tables 4.6–4.9, all suggest that many of these trends have been considerably strengthened. The average farm size, however, has fallen considerably since the 1980s since the number of farms has, not surprisingly, also increased, due to bifurcation and inheritance.

Table 4.3
Distribution of the Operational Holdings by Size and Tenure in Pakistan: 1972 (in '000 farms and acres)

Farm size (acres)	All farms		Owner farms		Owner-cum-tenant farms		Tenant farms		Owner-operated area	Tenant-operated area				Area owner-cum-tenant farms				Area tenant farms		
	Number I	Acres II	Number III	Acres IV	Number V	Acres VI	Number VII	Acres VIII	IX	Total X	Share cropped XI	Leased or rented XII	Others XIII	Owner operated XIV	Share cropped XV	Leased or rented XVI	Others XVII	Share cropped XVIII	Leased or rented XIX	Others XX
A **All sizes** Pakistan	3,762 (100%) (100%)	49,061 (100%) (100%)	1,569 (42%) (100%)	19,400 (40%) (100%)	897 (24%) (100%)	15,160 (31%) (100%)	1,296 (34%) (100%)	14,500 (30%) (100%)	26,388 (54%) (100%)	22,672 (100%)	18,915 (100%)	3,344 (100%)	413 (100%)	6,988 (100%)	6,351 (100%)	1,584 (100%)	237 (100%)	12,564 (100%)	1,760 (100%)	176 (100%)
Punjab	2,375 (100%) (100%)	31,030 (100%) (100%)	1,006 (42%) (100%)	11,951 (39%) (100%)	683 (29%) (100%)	11,050 (36%) (100%)	684 (29%) (100%)	8,029 (26%) (100%)	16,957 (55%) (100%)	14,073 (100%)	11,404 (100%)	2,440 (100%)	229 (100%)	5,006 (100%)	4,719 (100%)	1,204 (100%)	121 (100%)	6,885 (100%)	1,236 (100%)	108 (100%)
Sindh	748 (100%) (100%)	9,460 (100%) (100%)	178 (24%) (100%)	2,909 (31%) (100%)	97 (13%) (100%)	1,760 (19%) (100%)	472 (63%) (100%)	4,790 (51%) (100%)	3,700 (39%) (100%)	5,759 (100%)	5,047 (100%)	634 (100%)	78 (100%)	791 (100%)	648 (100%)	270 (100%)	51 (100%)	4,399 (100%)	364 (100%)	27 (100%)
B **Under 5.0** Pakistan	1,059 (100%) (28%)	2,563 (100%) (5%)	650 (61%) (41%)	1,423 (56%) (7%)	125 (12%) (14%)	402 (16%) (3%)	284 (27%) (2%)	731 (29%) (5%)	1,618 (63%) (6%)	947 (4%)	789 (4%)	126 (4%)	32 (8%)	186 (3%)	171 (3%)	36 (2%)	9 (4%)	618 (5%)	90 (5%)	23 (13%)
Punjab	619 (100%) (26%)	1,503 (100%) (5%)	397 (64%) (39%)	896 (60%) (7%)	81 (13%) (12%)	270 (18%) (2%)	141 (23%) (21%)	336 (22%) (4%)	1,020 (68%) (6%)	482 (3%)	387 (3%)	77 (3%)	18 (8%)	124 (2%)	119 (3%)	23 (2%)	4 (3%)	268 (4%)	54 (4%)	14 (13%)
Sindh	138 (100%) (18%)	424 (100%) (4%)	49 (36%) (26%)	129 (30%) (4%)	9 (7%) (9%)	30 (7%) (2%)	84 (61%) (18%)	264 (62%) (6%)	141 (33%) (4%)	262 (5%)	272 (5%)	272 (5%)	1 (15%)	12 (2%)	17 (3%)	1 (0.37%)	0 (0%)	255 (6%)	8 (2%)	1 (4%)
C **5.0–12.5** Pakistan	1,501 (100%) (40%)	12,338 (100%) (25%)	449 (30%) (29%)	3,916 (32%) (20%)	381 (25%) (42%)	3,204 (26%) (21%)	621 (41%) (48%)	5,218 (42%) (36%)	5,288 (43%) (20%)	7,050 (31%)	6,282 (33%)	677 (20%)	91 (22%)	1,372 (20%)	1,553 (24%)	245 (15%)	34 (14%)	4,729 (38%)	432 (25%)	57 (32%)
Punjab	926 (100%) (39%)	7,619 (100%) (25%)	332 (36%) (33%)	2,604 (34%) (22%)	296 (32%) (43%)	2,502 (33%) (23%)	298 (32%) (44%)	2,513 (33%) (31%)	3,667 (48%) (22%)	3,942 (28%)	3,392 (30%)	497 (20%)	53 (23%)	1,072 (21%)	1,215 (26%)	195 (16%)	19 (16%)	2,177 (33%)	302 (24%)	34 (31%)
Sindh	387 (100%) (52%)	3,261 (100%) (34%)	65 (17%) (37%)	523 (16%) (18%)	44 (11%) (45%)	376 (12%) (21%)	278 (72%) (59%)	2,361 (72%) (49%)	689 (21%) (18%)	2,591 (45%)	2,495 (49%)	84 (13%)	12 (15%)	146 (18%)	210 (32%)	18 (7%)	2 (4%)	2,285 (52%)	66 (18%)	10 (37%)
D **12.5–25.0** Pakistan	794 (100%) (21%)	13,061 (100%) (27%)	248 (31%) (16%)	4,065 (31%) (21%)	250 (31%) (28%)	4,269 (33%) (28%)	296 (37%) (23%)	4,708 (36%) (32%)	5,904 (45%) (22%)	7,158 (32%)	6,218 (33%)	857 (26%)	83 (20%)	1,819 (26%)	2,013 (32%)	391 (25%)	45 (19%)	4,205 (33%)	466 (26%)	37 (21%)
Punjab	549 (100%) (23%)	8,942 (100%) (29%)	169 (31%) (17%)	2,732 (31%) (23%)	201 (37%) (29%)	3,427 (38%) (31%)	179 (33%) (26%)	3,782 (31%) (35%)	4,172 (47%) (25%)	4,769 (34%)	4,031 (35%)	684 (28%)	54 (24%)	1,440 (29%)	1,626 (34%)	331 (7%)	30 (25%)	2,405 (36%)	353 (29%)	24 (22%)
Sindh	165 (100%) (22%)	2,766 (100%) (29%)	39 (24%) (22%)	689 (25%) (24%)	29 (18%) (30%)	505 (18%) (29%)	96 (58%) (20%)	1,573 (57%) (33%)	904 (33%) (24%)	1,853 (32%)	1,736 (34%)	114 (18%)	13 (17%)	215 (27%)	247 (38%)	38 (14%)	5 (10%)	1,489 (34%)	76 (21%)	8 (30%)
E **25.0–50.0** Pakistan	289 (100%) (8%)	9,215 (100%) (19%)	111 (38%) (7%)	3,516 (38%) (18%)	99 (34%) (11%)	3,300 (35%) (22%)	79 (27%) (6%)	2,399 (26%) (17%)	5,024 (55%) (19%)	4,191 (18%)	3,372 (18%)	747 (22%)	72 (17%)	1,508 (5%)	1,374 (22%)	374 (24%)	44 (19%)	1,996 (16%)	373 (21%)	26 (16%)
Punjab	209 (100%) (9%)	5,606 (100%) (21%)	75 (36%) (7%)	2,349 (36%) (20%)	78 (37%) (11%)	2,571 (39%) (23%)	57 (27%) (8%)	1,687 (26%) (21%)	3,505 (53%) (21%)	3,102 (22%)	2,459 (22%)	595 (25%)	48 (21%)	1,156 (23%)	1,080 (23%)	307 (25%)	28 (23%)	1,379 (21%)	288 (23%)	20 (19%)
Sindh	39 (100%) (5%)	1,247 (100%) (13%)	16 (41%) (9%)	514 (41%) (18%)	10 (26%) (10%)	346 (28%) (20%)	12 (31%) (3%)	386 (31%) (8%)	680 (55%) (18%)	566 (10%)	439 (9%)	122 (19%)	5 (6%)	166 (21%)	125 (19%)	52 (19%)	3 (6%)	314 (7%)	70 (19%)	2 (7%)
F **50.0–150.0** Pakistan	103 (100%) (3%)	7,402 (100%) (15%)	50 (49%) (3%)	3,652 (49%) (19%)	36 (35%) (4%)	2,666 (35%) (18%)	16 (16%) (1%)	1,085 (15%) (7%)	5,000 (68%) (19%)	2,403 (11%)	1,704 (9%)	629 (19%)	70 (17%)	1,348 (19%)	926 (15%)	344 (22%)	48 (20%)	778 (6%)	285 (15%)	22 (13%)
Punjab	65 (100%) (3%)	4,569 (100%) (15%)	30 (46%) (3%)	2,177 (48%) (18%)	25 (38%) (4%)	1,777 (39%) (16%)	10 (15%) (1%)	615 (13%) (8%)	3,074 (67%) (18%)	1,495 (11%)	1,022 (9%)	483 (18%)	40 (17%)	897 (18%)	605 (13%)	346 (20%)	29 (24%)	417 (6%)	187 (15%)	11 (10%)
Sindh	13 (100%) (2%)	1,013 (100%) (11%)	8 (62%) (4%)	605 (60%) (21%)	4 (31%) (4%)	257 (26%) (15%)	2 (15%) (0.42%)	140 (14%) (3%)	745 (74%) (20%)	257 (5%)	166 (3%)	91 (14%)	10 (13%)	140 (18%)	40 (6%)	81 (30%)	6 (12%)	51 (1%)	85 (23%)	4 (15%)
G **150.0 and over** Pakistan	16 (100%) (0.43%)	4,482 (100%) (9.14%)	10 (63%) (0.64%)	2,796 (62%) (14.42%)	5 (31%) (0.56%)	1,324 (30%) (8.73%)	1 (6%) (0.8%)	359 (8%) (2.48%)	3,556 (79%) (13.48%)	925 (4.08%)	549 (2.90%)	310 (9.27%)	66 (16%)	758 (11%)	314 (5%)	195 (12%)	57 (24%)	235 (2%)	115 (7%)	9 (5%)
Punjab	7 (100%) (0.29%)	1,789 (100%) (5.77%)	5 (71%) (0.50%)	1,192 (57%) (9.97%)	2 (29%) (0.29%)	502 (28%) (4.54%)	0 (6%) (0.06%)	94 (5%) (1.17%)	1,508 (84%) (8.89%)	280 (99%)	111 (0.97%)	154 (6.31%)	15 (7%)	316 (8%)	73 (2%)	102 (8%)	11 (9%)	38 (1%)	52 (4%)	4 (4%)
Sindh	3 (100%) (0.40%)	748 (100%) (7.91%)	2 (67%) (1.12%)	448 (50%) (15.40%)	1 (33%) (1.03%)	235 (31%) (13.35%)	0 (10%) (0.06%)	66 (9%) (1.38%)	516 (75%) (15.61%)	188 (3.25%)	140 (2.77%)	12 (1.89%)	36 (14%)	113 (14%)	8 (1.23%)	80 (30%)	34 (67%)	4 (0.09%)	60 (16%)	2 (7%)

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981).

Table 4.4
Distribution of the Operational Holdings by Size and Tenure in Pakistan: 1980 (in '000 farms and acres)

	Farm size (acres)	All farms: Number	All farms: Acres	Owner farms: Number	Owner farms: Acres	Owner-cum-tenant farms: Number	Owner-cum-tenant farms: Acres	Tenant farms: Number	Tenant farms: Acres	Owner-operated area	Tenant-operated area: Total	Tenant-operated area: Share cropped	Tenant-operated area: Leased or rented	Tenant-operated area: Others	Area owner-cum-tenant farms: Owner operated	Area owner-cum-tenant farms: Share cropped	Area owner-cum-tenant farms: Leased or rented	Area owner-cum-tenant farms: Others	Area tenant farms: Share cropped	Area tenant farms: Leased or rented	Area tenant farms: Others
		I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	XIII	XIV	XV	XVI	XVII	XVIII	XIX	XX
A	**All sizes**																				
	Pakistan	4,069 (100%) (100%)	47,095 (100%) (100%)	2,227 (55%) (100%)	24,533 (52%) (100%)	789 (19%) (100%)	12,396 (26%) (100%)	1,054 (26%) (100%)	10,165 (22%) (100%)	30,274 (64%) (100%)	16,821 (100%)	13,589 (100%)	2,900 (100%)	332 (100%)	5,741 (100%)	5,078 (100%)	1,584 (100%)	157 (100%)	8,511 (100%)	1,479 (100%)	175 (100%)
	Punjab	2,544 (100%) (100%)	29,898 (100%) (100%)	1,385 (54%) (100%)	14,883 (50%) (100%)	618 (24%) (100%)	9,334 (31%) (100%)	542 (21%) (100%)	5,681 (19%) (100%)	19,199 (64%) (100%)	10,749 (100%)	8,456 (100%)	2,083 (100%)	209 (100%)	4,266 (100%)	3,912 (100%)	1,204 (100%)	93 (100%)	4,544 (100%)	1,020 (100%)	117 (100%)
	Sindh	795 (100%) (100%)	9,207 (100%) (100%)	323 (41%) (100%)	4,350 (47%) (100%)	85 (11%) (100%)	1,528 (17%) (100%)	386 (49%) (100%)	3,328 (36%) (100%)	5,091 (55%) (100%)	4,116 (100%)	3,452 (100%)	617 (100%)	47 (100%)	741 (100%)	489 (100%)	270 (100%)	16 (100%)	2,963 (100%)	334 (100%)	31 (100%)
B	**Under 5.0**																				
	Pakistan	1,386 (100%) (34%)	3,320 (100%) (7%)	920 (66%) (41%)	2,173 (65%) (9%)	124 (9%) (16%)	392 (12%) (3%)	283 (20%) (27%)	755 (23%) (7%)	2,345 (71%) (8%)	974 (6%)	626 (6%)	134 (5%)	14 (4%)	173 (3%)	181 (4%)	36 (2%)	9 (6%)	645 (8%)	96 (7%)	11 (6%)
	Punjab	804 (100%) (32%)	1,938 (100%) (6%)	586 (73%) (42%)	1,327 (68%) (9%)	88 (11%) (14%)	289 (15%) (3%)	150 (19%) (28%)	326 (17%) (6%)	193 (10%) (1%)	483 (4%)	588 (7%)	86 (4%)	9 (4%)	127 (3%)	130 (3%)	23 (2%)	2 (2%)	257 (6%)	61 (6%)	7 (6%)
	Sindh	202 (100%) (25%)	527 (100%) (6%)	98 (49%) (30%)	259 (49%) (6%)	9 (4%) (11%)	31 (6%) (2%)	94 (47%) (24%)	295 (56%) (9%)	272 (52%) (5%)	314 (8%)	306 (9%)	7 (1%)	1 (2%)	13 (2%)	17 (3%)	1 (0.37%)	0 (0%)	289 (10%)	6 (2%)	1 (3%)
C	**5.0–12.5**																				
	Pakistan	1,604 (100%) (39%)	12,855 (100%) (27%)	724 (45%) (33%)	5,646 (44%) (23%)	352 (22%) (45%)	2,907 (23%) (23%)	528 (33%) (50%)	4,301 (33%) (42%)	6,096 (54%) (23%)	5,947 (35%)	5,231 (38%)	662 (23%)	54 (16%)	1,261 (22%)	1,401 (28%)	245 (15%)	14 (9%)	3,829 (45%)	431 (29%)	41 (23%)
	Punjab	996 (100%) (39%)	8,014 (100%) (27%)	463 (46%) (33%)	3,591 (45%) (24%)	285 (29%) (46%)	2,363 (29%) (25%)	249 (25%) (46%)	2,509 (26%) (36%)	8,014(100%) (42%)	3,399 (32%)	2,857 (34%)	504 (24%)	37 (18%)	1,024 (24%)	1,131 (29%)	195 (16%)	10 (11%)	1,729 (38%)	306 (30%)	27 (23%)
	Sindh	401 (100%) (50%)	3,297 (100%) (36%)	126 (31%) (39%)	1,008 (31%) (23%)	39 (10%) (46%)	325 (10%) (21%)	236 (59%) (61%)	1,902 (58%) (57%)	1,143 (35%) (22%)	2,093 (51%)	2,000 (58%)	80 (13%)	12 (26%)	135 (18%)	175 (33%)	18 (7%)	1 (6%)	1,824 (62%)	68 (20%)	11 (33%)
D	**12.5–25.0**																				
	Pakistan	705 (100%) (17%)	11,617 (100%) (25%)	323 (46%) (15%)	5,339 (46%) (22%)	198 (28%) (25%)	3,358 (29%) (27%)	185 (26%) (18%)	2,920 (25%) (29%)	6,824 (59%) (23%)	4,794 (29%)	3,970 (29%)	751 (26%)	73 (22%)	1,484 (26%)	1,524 (30%)	391 (25%)	28 (18%)	2,446 (29%)	429 (29%)	45 (26%)
	Punjab	494 (100%) (19%)	7,981 (100%) (27%)	213 (43%) (15%)	3,427 (43%) (23%)	159 (32%) (26%)	2,390 (30%) (26%)	122 (25%) (23%)	1,864 (23%) (33%)	7,981(100%) (35%)	3,387 (701%)	2,746 (32%)	587 (28%)	54 (26%)	1,167 (27%)	1,234 (32%)	331 (27%)	19 (20%)	1,512 (33%)	318 (31%)	34 (29%)
	Sindh	132 (100%) (17%)	2,258 (100%) (25%)	62 (47%) (19%)	1,083 (48%) (25%)	22 (17%) (26%)	385 (17%) (25%)	48 (36%) (12%)	79 (35%) (24%)	1,266 (56%) (25%)	993 (24%)	850 (25%)	130 (21%)	13 (28%)	183 (25%)	157 (32%)	38 (14%)	4 (25%)	692 (23%)	89 (27%)	9 (29%)
E	**25.0–50.0**																				
	Pakistan	264 (100%) (6%)	8,386 (100%) (18%)	131 (50%) (6%)	4,169 (17%)	84 (32%) (11%)	2,770 (33%) (22%)	48 (18%) (5%)	1,448 (17%) (14%)	5,444 (65%) (18%)	2,942 (17%)	2,232 (16%)	636 (22%)	75 (23%)	1,275 (22%)	1,107 (22%)	374 (24%)	35 (22%)	1,125 (13%)	284 (19%)	39 (22%)
	Punjab	184 (100%) (7%)	5,792 (100%) (19%)	84 (46%) (6%)	2,640 (46%) (18%)	64 (35%) (10%)	2,118 (37%) (23%)	35 (19%) (7%)	1,034 (18%) (18%)	5,792(100%) (30%)	2,199 (20%)	1,673 (20%)	469 (23%)	57 (27%)	953 (22%)	871 (22%)	307 (25%)	27 (29%)	802 (18%)	201 (20%)	31 (26%)
	Sindh	43 (100%) (5%)	1,393 (100%) (15%)	25 (58%) (8%)	827 (59%) (19%)	11 (26%) (13%)	358 (26%) (23%)	7 (16%) (2%)	209 (15%) (6%)	1,009 (72%) (20%)	384 (9%)	224 (6%)	150 (24%)	10 (21%)	182 (25%)	95 (19%)	52 (19%)	4 (25%)	129 (4%)	73 (22%)	6 (19%)
F	**50.0–150.0**																				
	Pakistan	96 (100%) (2%)	6,913 (100%) (15%)	59 (61%) (3%)	4,267 (62%) (17%)	28 (29%) (4%)	2,052 (30%) (17%)	9 (9%) (1%)	593 (9%) (6%)	5,319 (77%) (18%)	1,594 (9%)	1,057 (8%)	462 (16%)	74 (22%)	1,052 (18%)	689 (13%)	344 (22%)	45 (29%)	389 (5%)	175 (12%)	29 (17%)
	Punjab	59 (100%) (2%)	4,230 (100%) (14%)	34 (58%) (2%)	2,468 (58%) (17%)	20 (34%) (3%)	1,417 (33%) (15%)	5 (9%) (1%)	345 (8%) (6%)	423 (10%) (2%)	1,034 (10%)	682 (8%)	310 (15%)	42 (20%)	729 (17%)	459 (12%)	246 (20%)	27 (29%)	223 (5%)	106 (10%)	16 (14%)
	Sindh	15 (100%) (2%)	1,088 (100%) (12%)	10 (67%) (3%)	740 (68%) (17%)	3 (20%) (4%)	256 (24%) (17%)	1 (7%) (0.3%)	92 (8%) (3%)	883 (81%) (17%)	206 (5%)	62 (2%)	140 (23%)	4 (9%)	143 (19%)	37 (8%)	81 (30%)	2 (13%)	26 (1%)	65 (19%)	5 (2%)
G	**150.0 and over**																				
	Pakistan	14 (100%) (0.34%)	4,004 (100%) (8.50%)	10 (71%) (0.45%)	2,939 (73%) (11.96%)	3 (21%) (0.38%)	917 (23%) (7.40%)	1 (7%) (0.09%)	148 (4%) (1.46%)	3,434 (86%) (11.34%)	570 (3.39%)	273 (2.01%)	255 (8.79%)	42 (13%)	469 (9%)	196 (4%)	196 (12%)	32 (20%)	77 (1%)	62 (4%)	10 (6%)
	Punjab	7 (100%) (0.28%)	1,943 (100%) (6.50%)	5 (71%) (0.36%)	1,430 (74%) (9.61%)	2 (29%) (0.32%)	460 (24%) (4.93%)	0 (3%) (0.04%)	53 (3%) (0.931%)	194 (10%) (1.01%)	247 (2.30%)	110 (1.30%)	127 (6.10%)	10 (5%)	266 (6%)	87 (2%)	102 (8%)	8 (9%)	24 (1%)	28 (3%)	2 (2%)
	Sindh	2 (100%) (0.25%)	644 (100%) (6.99%)	1 (50%) (0.31%)	433 (67%) (9.95%)	1 (50%) (1.18%)	173 (27%) (11.32%)	0 (10%) (0.05%)	39 (6%) (1.17%)	518 (80%) (10.17%)	126 (3.06%)	10 (0.29%)	110 (7.83%)	7 (15%)	85 (11%)	85 (11%)	80 (30%)	5 (31%)	3 (0.10%)	33 (10%)	2 (6%)

Source: Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981).

Table 4.5
Number, Area of the Farms by Size of Farms, and Average Size of Farms: 1990, 2000 and 2010 Comparative Analysis

Farm Size	1990		2000		2010		1990		2000		2010		1990	2000	2010
(000 acres)	Number	%	Number	%	Number	%	000 Acres	%	000 Acres	%	000 Acres	%	Average size of Farms (acres)		
All sizes															
Pakistan	5,071	100	6,620	100	8,265	100	47,319	100	50,425	100	52,910	100	9.3	7.6	6.4
Punjab	2,957	100	3,864	100	5,250	100	27,107	100	27,762	100	29,326	100	9.2	7.2	5.6
Sindh	802	100	1,070	100	1,115	100	8,604	100	10,687	100	9,869	100	10.7	10.0	8.8
KPK	1,069	100	1,356	100	1,540	100	5,828	100	5,589	100	5,570	100	5.5	4.1	3.6
Balochistan	243	100	330	100	360	100	5,780	100	6,387	100	8,145	100	23.8	19.4	22.7
Under 5.0															
Pakistan	2,404	47.41	3,815	57.63	5,351	64.75	5,314	11.23	7,822	15.51	10,184	19.25	2.2	2.1	1.9
Punjab	1,343	45.40	2,165	56.03	3,347	63.76	3,009	11.10	4,515	16.26	6,512	22.20	2.2	2.1	1.9
Sindh	266	33.22	491	45.88	629	56.44	768	8.93	1,347	12.61	1,502	15.22	2.9	2.7	2.4
KPK	741	69.33	1,065	78.55	1,245	80.82	1,401	24.04	1,733	31.01	1,865	33.49	1.9	1.6	1.5
Balochistan	54	22.23	94	28.42	129	35.99	135	2.34	226	3.54	305	3.74	2.5	2.4	2.4
5.0–12.5															
Pakistan	1,700	33.53	1,858	28.06	2,049	24.79	13,072	27.63	14,092	27.95	15,242	28.81	7.7	7.6	7.4
Punjab	1,007	34.05	1,135	29.37	1,413	26.91	7,787	28.73	8,619	31.04	10,478	35.73	7.7	7.6	7.4
Sindh	376	46.85	391	36.57	297	26.67	2,889	33.58	2,961	27.70	2,225	22.55	7.7	7.6	7.5
KPK	233	21.82	218	16.11	221	14.34	1,705	29.26	1,582	28.30	1,596	28.66	7.3	7.2	7.2
Balochistan	84	34.70	113	34.35	118	32.85	690	11.95	931	14.58	941	11.56	8.2	8.2	8.0
12.5–25.0															
Pakistan	622	12.27	580	8.76	561	6.79	10,213	21.58	9,614	19.07	9,361	17.69	16.4	16.6	16.7
Punjab	406	13.71	368	9.53	359	6.85	6,504	23.99	5,987	21.56	5,813	19.82	16.0	16.3	16.2
Sindh	108	13.52	102	9.57	98	8.76	1,860	21.61	1,758	16.45	1,785	18.08	17.2	17.2	18.3
KPK	60	5.57	43	3.20	49	3.20	992	17.02	724	12.95	830	14.90	16.7	16.7	16.9
Balochistan	49	20.12	66	19.95	54	15.13	857	14.82	1,146	17.93	934	11.46	17.5	17.4	17.2

Table 4.5 (contd.)

Farm Size	1990		2000		2010		1990		2000		2010		1990	2000	2010
(000 acres)	Number	%	Number	%	Number	%	000 Acres	%	000 Acres	%	000 Acres	%	Average size of Farms (acres)		
25.0–50															
Pakistan	238	4.68	261	3.94	211	2.55	7,489	15.83	8,210	16.28	6,726	12.71	31.5	31.5	31.9
Punjab	147	4.98	149	3.85	97	1.84	4,559	16.82	4,588	16.53	3,000	10.23	31.0	30.8	31.1
Sindh	34	4.21	58	5.43	64	5.74	1,097	12.75	1,889	17.68	2,088	21.16	32.5	32.5	32.6
KPK	25	2.34	19	1.44	18	1.18	810	13.90	619	11.08	572	10.27	32.4	31.8	31.5
Balochistan	32	13.01	34	10.34	32	8.93	1,024	17.71	1,113	17.43	1,065	13.08	32.4	32.6	33.2
50.0–150															
Pakistan	92	1.81	93	1.40	79	0.96	6,454	13.64	6,534	12.96	5,548	10.48	70.4	70.3	69.8
Punjab	48	1.64	42	1.10	30	0.57	3,401	12.55	2,898	10.44	2,068	7.05	70.2	68.4	69.7
Sindh	15	1.82	24	2.20	24	2.18	1,054	12.26	1,692	15.84	1,653	16.75	72.2	71.9	68.1
KPK	9	0.84	8	0.62	6	0.41	630	10.81	600	10.73	429	7.71	70.2	71.6	68.7
Balochistan	20	8.10	19	5.66	19	5.36	1,369	23.68	1,345	21.05	1,398	17.16	69.6	72.0	72.5
150.0 and above															
Pakistan	15	0.30	14	0.21	13	0.16	4,776	10.09	4,153	8.24	5,850	11.06	311.8	296.1	435.3
Punjab	7	0.23	5	0.13	4	0.08	1,847	6.81	1,156	4.16	1,455	4.96	275.7	235.5	358.3
Sindh	3	0.39	4	0.34	2	0.21	936	10.88	1,039	9.72	615	6.23	302.9	282.2	257.0
KPK	1	0.10	1	0.09	1	0.05	289	4.96	332	5.93	277	4.97	268.1	268.0	362.3
Balochistan	4	1.83	4	1.27	6	1.73	1,705	29.49	1,626	25.46	3,503	43.00	383.0	387.5	563.2

Source: Government of Pakistan, *Agricultural Census of Pakistan* (Islamabad: various editions).

Table 4.6
Tenure Classification of the Farms by Provinces

Unit	Number of farms (m)						
	Total I	Owner II		Owner-cum-tenant III		Tenant IV	
Census 1960							
Pakistan	4.859	1.998	(41.1%)	0.835	(17.2%)	2.026	(41.7%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	0.674	0.325	(48.2%)	0.137	(20.3%)	0.212	(31.5%)
	(13.9%)	(16.3%)		(16.4%)		(10.5%)	
Punjab	3.326	1.422	(42.8%)	0.623	(18.7%)	1.281	(38.5%)
	(68.5%)	(71.2%)		(74.6%)		(63.2%)	
Sindh	0.694	0.15	(21.6%)	0.061	(8.8%)	0.483	(69.6%)
	(14.3%)	(7.5%)		(7.3%)		(23.8%)	
Balochistan	0.165	0.101	(61.2%)	0.014		0.05	(30.3%)
	(3.4%)	(5.1%)		(1.7%)	(8.5%)	(2.5%)	
Census 1972							
Pakistan	3.76	1.568	(41.7%)	0.896	(23.8%)	1.296	(34.5%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	0.466	0.256	(54.9%)	0.103	(22.1%)	0.107	(23%)
	(12.4%)	(16.3%)		(11.5%)		(8.3%)	
Punjab	2.375	1.008	(42.4%)	0.683	(28.8%)	0.684	(28.8%)
	(63.2%)	(64.3%)		(76.2%)		(52.8%)	
Sindh	0.747	0.178	(23.8%)	0.097	(13.0%)	0.472	(63.2%)
	(19.9%)	(11.4%)		(10.8%)		(36.4%)	
Balochistan	0.172	0.126	(73.3%)	0.013	(7.6%)	0.033	(19.2%)
	(4.6%)	(8.0%)		(1.5%)		(2.5%)	
Census 1980							
Pakistan	4.07	2.227	(54.7%)	0.789	(19.4%)	1.054	(25.9%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	0.528	0.361	(68.4%)	0.072	(13.6%)	0.095	(18%)
	(13.0%)	(16.2%)		(9.1%)		(9.0%)	
Punjab	2.545	1.385	(54.4%)	0.618	(24.3%)	0.542	(21.3%)
	(62.5)	(62.2%)		(78.3%)		(51.4%)	
Sindh	0.795	0.323	(40.6%)	0.085	(10.7%)	0.387	(48.7%)
	(19.5%)	(14.5%)		(10.8%)		(36.7%)	
Balochistan	0.202	0.158	(78.2%)	0.014	(6.9%)	0.03	(14.9%)
	(5.0%)	(7.1%)		(1.8%)		(2.8%)	
Census 1990							
Pakistan	5.071	3.491	(68.8%)	0.626	(12.3%)	0.954	(18.7%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	1.069	0.835	(78.1%)	0.0.89	(8.3%)	0.145	
	(21.1%)	(23.9%)		(14.2%)		(15.3%)	(13.6%)
Punjab	2.957	2.054	(69.5%)	0.464	(15.7%)	0.439	
	(58.3)	(58.8%)		(74.1%)		(46.4%)	(14.8%)
Sindh	0.802	0.406	(50.6%)	0.061	(7.6%)	0.335	
	(15.8%)	(11.6%)		(9.7%)		(35.4%)	(41.8%)
Balochistan	0.243	0.196	(80.7%)	0.012	(4.9%)	0.035	
	(4.8%)	(5.6%)		(1.9%)		(3.7%)	(14.4%)

Table 4.6 (contd.)

Unit	Number of farms (m)						
	Total I	Owner II		Owner-cum-tenant III		Tenant IV	
Census 2000							
Pakistan	6.620	5.135	(77.6%)	0.559	(8.4%)	0.927	(14.0%)
	(100%)	(100%)		(100%)		(100%)	
KPK	1.356	1.124	(82.9%)	0.084	(6.2%)	0.148	(10.9%)
	(20.5%)	(21.9%)		(15.0%)		(16.0%)	
Punjab	3.864	3.037	(78.6%)	0.424	(11.0%)	0.403	(10.4%)
	(58.4%)	(59.2%)		(75.8%)		(43.5%)	
Sindh	1.070	0.704	(65.8%)	0.043	(4.0%)	0.323	(30.2%)
	(16.2%)	(13.7%)		(7.7%)		(34.9%)	
Balochistan	0.330	0.270	(81.8%)	0.009	(2.6%)	0.051	(15.6%)
	(5.0%)	(5.3%)		(1.6%)		(5.5%)	
Census 2010							
Pakistan	8.264	6.744	(81.6%)	0.604	(7.3%)	0.916	(11.1%)
	(100%)	(100%)		(100%)		(100%)	
KPK	1.540	1.340	(87.0%)	0.093	(6.1%)	0.107	(6.9%)
	(18.6%)	(19.9%)		(15.5%)		(11.7%)	
Punjab	5.250	4.325	(82.4%)	0.452	(8.6%)	0.473	(9.0%)
	(63.5%)	(64.1%)		(74.8%)		(51.6%)	
Sindh	1.115	0.784	(70.3%)	0.045	(4.0%)	0.286	(25.7%)
	(13.5%)	(11.6%)		(7.5%)		(31.2%)	
Balochistan	0.360	0.296	(82.2%)	0.014	(3.8%)	0.050	(14.0%)
	(4.4%)	(4.4%)		(2.2%)		(5.5%)	

Source: Government of Pakistan, *Census of Agriculture* (Islamabad: various editions).

Table 4.7
Tenure Classification of Farms' Area by Provinces

Unit	Farms area (m acres)						
	Total I	Owner II		Owner-cum-tenant III		Tenant IV	
Census 1960							
Pakistan	48.926	18.721	(38.3%)	11.011	(22.5%)	19.194	(39.2%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	5.463	1.187	(21.7%)	1.871	(34.2%)	1.722	(31.5%)
	(11.2%)	(6.3%)		(17%)		(9%)	
Punjab	29.212	11.168	(38.2%)	7.18	(24.6%)	10.864	(37.2%)
	(59.7%)	(59.7%)		(65.2%)		(56.6%)	
Sindh	10.19	3.229	(31.7%)	1.474	(14.5%)	5.487	(53.8%)
	(20.8%)	(17.2%)		(13.4%)		(28.6%)	
Balochistan	4.061	2.454	(60.4%)	0.486	(12%)	1.121	(27.6%)
	(8.3%)	(13.1%)		(4.4%)		(5.8%)	
Census 1972							
Pakistan	49.058	19.398	(39.5%)	15.16	(30.9%)	14.5	(29.6%)
	(100%)	(100%)		(100%)		(100%)	
NWFP	4.251	1.615	(38%)	1.713	(40.3%)	0.923	(21.7%)
	(8.7%)	(8.3%)		(11.3%)		(6.4%)	
Punjab	31.029	11.95	(38.5%)	11.051	(35.6%)	8.028	(25.9%)
	(63.2%)	(61.6%)		(72.9%)		(55.4%)	
Sindh	9.459	2.909	(30.8%)	1.759	(18.6%)	4.791	(50.7%)
	(19.3%)	(15%)		(11.6%)		(33%)	
Balochistan	4.319	2.924		0.637	(14.7%)	0.758	(17.6%)
	(8.8%)	(15.1%)	(67.7%)	(4.2%)		(5.2%)	

Table 4.7 (contd.)

Unit	Farms area (m acres)						
	Total I	Owner II		Owner-cum-tenant III		Tenant IV	
<u>Census 1980</u>							
Pakistan	47.094 (100%)	24.533 (100%)	(52.1%)	12.396 (100%)	(26.3%)	10.165 (100%)	(21.6%)
NWFP	4.099 (8.7%)	2.388 (9.7%)	(58.3%)	1.103 (8.9%)	(26.9%)	0.608 (6%)	(14.8%)
Punjab	28.898 (61.4%)	14.883 (60.7%)	(51.5%)	9.334 (75.3%)	(32.3%)	5.681 (55.9%)	(19.7%)
Sindh	9.206 (19.5%)	4.35 (17.7%)	(47.3%)	1.528 (12.3%)	(16.6%)	3.328 (32.7%)	(36.2%)
Balochistan	3.891 (8.3%)	2.912 (11.9%)	(74.8%)	0.431 (3.5%)	(11.1%)	0.584 (5.7%)	(15%)
<u>Census 1990</u>							
Pakistan	47.319 (100%)	30.723 (100%)	(64.9%)	8.982 (100%)	(19%)	7.614 (100%)	(16.1%)
NWFP	5.828 (12.3%)	4.251 (13.8%)	(72.9%)	0.902 (10%)	(15.5%)	0.675 (8.9%)	(11.6%)
Punjab	27.107 (57.3%)	16.656 (54.2%)	(61.4%)	6.604 (73.5%)	(24.4%)	3.847 (50.5%)	(14.2%)
Sindh	8.604 (18.2%)	5.098 (16.6%)	(59.3%)	1.04 (11.6%)	(12.1%)	2.466 (32.4%)	(28.7%)
Balochistan	5.78 (12.2%)	4.718 (15.4%)	(81.6%)	0.436 (4.6%)	(7.5%)	0.626 (8.2%)	(10.8%)
<u>Census 2000</u>							
Pakistan	50.425 (100%)	36.969 (100%)	(73.3%)	7.323 (100%)	(14.5%)	6.133 (100%)	(12.2%)
KPK	5.589 (11.1%)	4.243 (11.5%)	(75.9%)	0.805 (11.0%)	(14.4%)	0.541 (8.8%)	(9.7%)
Punjab	27.762 (55.1%)	19.249 (52.1%)	(69.3%)	5.401 (73.8%)	(19.5%)	3.113 (50.8%)	(11.2%)
Sindh	10.687 (21.2%)	8.113 (21.9%)	(75.9%)	0.736 (10.1%)	(6.9%)	1.838 (30.0%)	(17.2%)
Balochistan	6.387 (12.7%)	5.365 (14.5%)	(84.0%)	0.381 (5.2%)	(6.0%)	0.642 (10.5%)	(10.0%)
<u>Census 2010</u>							
Pakistan	52.910 (100%)	39.432 (100%)	(74.5%)	7.584 (100%)	(14.3%)	5.894 (100%)	(11.1%)
KPK	5.570 (10.5%)	4.348 (11.0%)	(78.1%)	0.797 (10.5%)	(14.3%)	0.424 (7.2%)	(7.6%)
Punjab	29.326 (55.4%)	20.602 (52.2%)	(70.3%)	5.368 (70.8%)	(18.3%)	3.356 (56.9%)	(11.4%)
Sindh	9.869 (18.7%)	7.830 (19.9%)	(79.3%)	0.746 (9.8%)	(7.6%)	1.294 (21.9%)	(13.1%)
Balochistan	8.145 (15.4%)	6.652 (16.9%)	(81.7%)	0.673 (8.9%)	(8.3%)	0.821 (13.9%)	(10.1%)

Source: Government of Pakistan, *Census of Agriculture* (Islamabad: various editions).

Table 4.8
Tenure Classification of the Farms and Area by Provinces (Index 2000=100)

Unit	Number of farms (m)				Farm's area (m acres)			
	Total	Owner	Owner Cum Tenant	Tenant	Total	Owner	Owner Cum Tenant	Tenant
Census 1960								
Pakistan	73.40	38.91	149.38	218.66	97.03	50.64	150.37	312.95
KPK	49.70	28.91	163.60	142.79	97.74	27.98	232.32	318.30
Punjab	86.07	46.82	147.10	317.52	105.22	58.02	132.95	349.01
Sindh	64.87	21.32	141.81	149.38	95.35	39.80	200.24	298.55
Balochistan	50.02	37.43	160.44	97.45	63.58	45.74	127.72	174.74
Census 1972								
Pakistan	56.80	30.54	160.29	139.87	97.29	52.47	207.03	236.42
KPK	34.36	22.78	123.00	72.07	76.06	38.06	212.71	170.61
Punjab	61.46	33.19	161.27	169.54	111.77	62.08	204.62	257.90
Sindh	69.82	25.30	225.50	145.97	88.51	35.86	238.95	260.68
Balochistan	52.14	46.70	148.98	64.32	67.62	54.50	167.40	118.16
Census 1980								
Pakistan	61.48	43.37	141.15	113.75	91.41	66.36	169.28	166.32
KPK	38.93	32.12	85.98	63.99	73.34	56.28	136.96	112.38
Punjab	65.86	45.60	145.92	134.35	104.09	77.32	172.83	182.50
Sindh	74.31	45.91	197.61	119.69	86.15	53.62	207.57	181.08
Balochistan	61.24	58.56	160.44	58.47	60.92	54.27	113.27	91.03
Census 1990								
Pakistan	76.60	67.99	111.99	102.96	93.84	83.10	122.66	124.14
KPK	78.82	74.29	106.28	97.66	104.27	100.19	112.00	124.77
Punjab	76.53	67.63	109.56	108.81	97.64	86.53	122.28	123.59
Sindh	74.96	57.71	141.81	103.60	80.51	62.84	141.28	134.18
Balochistan	73.67	72.64	137.52	68.21	90.49	87.93	114.58	97.58
Census 2000								
Pakistan	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
KPK	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Punjab	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Sindh	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Balochistan	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Census 2010								
Pakistan	162.98	193.18	96.54	96.03	111.82	128.35	84.44	77.41
KPK	144.04	160.43	105.04	73.64	95.57	102.28	88.40	62.89
Punjab	177.54	210.55	97.48	107.69	108.19	123.69	81.29	87.23
Sindh	139.06	193.13	73.87	85.41	114.70	153.58	71.68	52.46
Balochistan	147.97	150.81	112.63	144.17	140.93	140.99	154.31	131.09

Tenure classification of the farms and area by provinces (Index 2000 = 100)
Note: Base Year for National Income Accounts and Monetary Statistics is year 2000
Source: This table is prepared from Tables 4.6 and 4.7.

Table 4.9
Average Size of Operational Holding: 1960–2010

Farm size (acres)	1960	1972	1980	1990	2000	2010
All sizes						
Pakistan	10.07	13.04	11.57	9.38	7.6	6.4
Punjab	8.78	13.07	11.75	9.20	7.2	5.6
Sindh	9.91	12.65	11.58	10.76	10.0	8.8
Under 5.0						
Pakistan	1.91	2.42	2.40	2.98	2.1	1.9
Punjab	1.86	2.43	2.41	2.96	2.1	1.9
Sindh	3.04	3.07	2.61	2.88	2.7	2.4
5.0–12.5						
Pakistan	8.14	8.22	8.01	7.69	7.6	7.4
Punjab	8.14	8.23	8.05	7.73	7.6	7.4
Sindh	8.23	8.43	8.22	7.69	7.6	7.5
12.5–25.0						
Pakistan	17.19	16.45	16.48	16.40	16.6	16.7
Punjab	17.06	16.29	16.16	16.02	16.3	16.2
Sindh	17.46	16.76	17.11	17.15	17.2	18.3
25.0–50.0						
Pakistan	33.10	31.89	31.77	31.50	31.5	31.9
Punjab	32.79	31.62	31.48	30.94	30.8	31.1
Sindh	33.51	31.97	32.40	32.48	32.5	32.6
50.0–150.0						
Pakistan	74.31	71.86	72.01	70.33	70.3	69.8
Punjab	100.70	70.29	71.69	70.11	68.4	69.7
Sindh	171.50	77.92	72.53	72.22	71.9	68.1
150.0 and over						
Pakistan	349.70	280.10	286.00	311.44	296.1	435.3
Punjab	285.20	255.60	277.60	275.09	235.5	358.3
Sindh	398.50	249.30	322.00	302.74	282.2	257.0

Source: Government of Pakistan, *Census of Agriculture* (Islamabad: various years).

4.3 Summary and Further Reading

4.3.1 Summary

This has not been an easy chapter to deal with. It has been made cumbersome by the huge array of numbers presented here, which are no doubt off-putting for many readers. Nevertheless, we could not avoid the reference to these very useful and essential numbers. They bring together very important data from the 1950s to the present, and allow the interested reader to expand on the simplified and brief analysis presented here.

The essential purpose of the data presented is to enable the observation and study of the pattern of agricultural transition. We observe that tenancy and sharecropping, essential cornerstones of feudalism, have fallen drastically, both in the number of farms and in the area farmed. Tenancy farms and sharecroppers have been replaced by owner-operated farms. This is a major change in the pattern of agricultural production in Pakistan and shows the direction for the future. This chapter has also tried to show how different classes in agriculture coexist and the nature of their relationship with each other.

4.3.2 Further Reading

Although a number of books and papers have contributed on the agricultural sector in Pakistan, most have presented a static analysis and have not been concerned with change or transition over a period of time. The *process* itself has not been observed, and analysis has often been restricted to one point in time. This is a major shortcoming of such work, for it does not show how the present situation and structure have evolved. One major exception has been the work by Professor Mahmood Hasan Khan of Simon Fraser University, Canada, whose *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), and *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985), present a historical analysis and the process of development. Some of the references listed in Chapter 3, dealing with the Green Revolution, which was an important impetus to the nature and direction of the change discussed in this chapter, would also be useful for the reader.

Table 4.10
Summary Data on Number, Size, Area and Operational Status of Farms by Tenure Based on Agricultural Census Data: 1960–80

Private farms		Pure owner farms	Owner-cum-tenant farms			Pure tenant farms	All private farms
			Owner	Tenant	Total		
Numbers (m)							
	1960	1.998	n.a.	n.a.	0.834	2.028	4.86
	1972	1.569	n.a.	n.a.	0.897	1.296	3.762
	1980	2.227	n.a.	n.a.	0.789	1.054	4.07
Ave. farm size (m acres)							
	1960	10.06	n.a.	n.a.	13.20	9.46	10.07
	1972	13.04	n.a.	n.a.	16.90	11.19	13.04
	1980	11.57	n.a.	n.a.	15.71	9.65	11.57
Farm area (m acres)							
	1960	18.723	6.235	6.107	12.342	17.864	48.929
	1972	19.399	6.988	8.172	15.16	14.5	49.059
	1980	24.533	5.741	6.655	12.396	10.166	47.095
Area operated by (m acres):							
Owner	1960	18.723	6.235	–	6.235	–	24.958
	1972	19.399	6.988	–	6.988	–	26.387
	1980	24.533	5.741	–	5.741	–	30.274
Sharecropper	1960	–	–	7.776	4.776	16.495	21.271
	1972	–	–	6.351	6.351	12.564	18.915
	1980	–	–	5.078	5.078	8.511	13.589
Lease holder	1960	–	–	0.979	0.979	0.962	2.941
	1972	–	–	1.584	1.584	1.76	3.344
	1980	–	–	1.421	1.421	1.479	2.9
Other	1960	–	–	0.352	0.352	0.407	0.759
	1972	–	–	0.237	0.237	0.176	0.413
	1980	–	–	0.156	0.156	0.175	0.322

n.a. = not available.
Note: (1) 1 ha = 2.47 acres.
(2) The 1960 Census, based on an extractive survey of the land revenue records, may not be comparable to the 1972 and 1980 Censuses, based on population surveys.
Source: Government of Pakistan, *Pakistan Economic Survey 1994–95* (Islamabad, 1995).

Appendix 4.1

Classes in Agriculture

Mahmood Hasan Khan in *Lectures on Agrarian Transformation* writes:

> There are at present five distinct classes in the agricultural sector of Pakistan.
>
> First, there are landlords who own large areas of land and rent almost all of it in small parcels to landless sharecroppers. Landlords do not rent or lease land from others. Labour is entirely provided by the sharecropper households. Landlords neither work for themselves nor provide their labour-power to others. Their overlordship on land is exercised mainly through their agents (*kamdars*). In Sindh, for instance, sharecroppers play no role in production decisions. Profits and wages as economic rewards do not exist here; only rent exists. Primordial and traditional factors, and not economic considerations, play a central role in determining the nexus of landlords and tenants, including their shares in output.
>
> Secondly, there are farmers. Contrary to the popular perception in Pakistan that there are 'farmers' with complete homogeneity of interests, I emphasize heterogeneity. The capitalist farmers, who can also be called rich peasants, may own most or some of the land they cultivate and rent or lease from others part of it. They do not normally rent or lease their lands to others. Others' labour is the basis of production and source of surplus value for capitalist farmers. Landless workers or the so called free labour are hired for wages. Rich peasants do not sell their labour-power to others: they work on their land as entrepreneurs *par excellence*. They organize production, supervise free labour, and innovate. Profit and wages appear as basic economic categories for the first time in the distribution of output, although rent may still remain as an important component of income. Rent does not disappear.
>
> Thirdly, there is the class of family farmers who could be called middle peasants. This class consists of farmers who may own, rent or lease part of the land they cultivate. They may even rent, or lease out part of their land to others. However, these landowners depend almost entirely on family or household labour for production. They usually do not work for others, nor do they hire others to work on their farms. These farms are probably nearest to the classic peasant farm of Chayanov, the famous Russian economist who gave this idea and developed a theory of peasantry. Chayanovian peasants have shown great resilience in the face of capitalistic development of agriculture in history in Russia and other countries.
>
> Fourthly, there is the class of sharecroppers, or *haris* as they are called in Sindh. Landless sharecroppers rent all the land they cultivate and share the output with landlords on some traditionally-determined basis, often in kind. This class may include some poor peasants, whom I call marginal landowners and who must supplement their meager income by sharecropping on small farms of land rented from the landlord or others. Sharecroppers do not hire labour and depend almost entirely on their household labour. They may sell their labour-power to landowners to supplement their meager income. They are the linchpin in the feudal system which exists in parts of Pakistan even today.
>
> The fifth and final class is that of wage workers. This class consists of what I call unattached (landless) workers, who must earn income by selling their labour-power. They work mainly for rich peasants or capitalist farmers. Their wage is partly in cash and partly in kind. They may work on a permanent basis but most of them find only seasonal work. They may supplement their incomes by working outside agriculture. These workers constitute the burgeoning proletariat for agriculture and industry.
>
> I want to clarify here three points in [Table 4]. First, hiring of labour by landlords implies use of share-croppers, i.e. the labour power of others. It is a reference to the attached labour. Secondly, family farmers may work for others either in or outside agriculture. This, of course, depends on the requirement of the family farm and the level of income of the household to reproduce its labour power. Thirdly, share-croppers may also work for others outside the landlord-tenant nexus, either in or outside agriculture. Finally, leasing of land by capitalist farmers or rich peasants could be either from landlords to whom they pay the ground rent or from the middle to poor peasants on fixed payments.

Table 1
Agrarian class differentiation in Pakistan

Class	Land	Labour
1 Landlords	$LO > 0$	$SE = 0$
	$LR_o > 0$	$HL_i > 0$
	$LR_i = 0$	$HL_o = 0$
2 Capitalist farmers (rich peasants)	$LO > 0$	$SE > 0$
	$LR_o = 0$	$HL_i > 0$
	$LR_i > 0$	$HL_o = 0$
3 Family farmers (middle or poor peasants)	$LO > 0$	$SE > 0$
	$LR_o > 0$	$HL_i = 0$
	$LR_i > 0$	$HL_o > 0$
4 Sharecroppers	$LO = 0$	$SE > 0$
	$LR_o = 0$	$HL_i = 0$
	$LR_i > 0$	$HL_o \geq 0$
5 Wage workers	$LO = 0$	$SE = 0$
	$LR_o = 0$	$HL_i > 0$
	$LR_i = 0$	$HL_o \geq 0$

Note: LO = land owned; LR_o = land rented out; LR_i = land rented in; SE = employment; HL_i = hiring in labour; HL_o = hiring out labour.

Source: Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985), 10–13.

Our typology cuts across the simplistic tenure categories of lessors and lessees. It also does not maintain a direct relationship to large and small holdings. Lessors could be landlords or even middle or poor peasants owning but not using land. Therefore, you may be lumping together in this

category different sorts of people such as landlords and small owners. Lessees could be capitalist farmers or sharecroppers and poor peasants supplementing their own holdings. So, you are putting together apples and oranges in one box. I am saying: get out of this box which is empty, nonsensical. A classification based on the arbitrary size and tenure categories does not reveal the true relations of production. They mystify the creation and appropriation of social surplus in agriculture. These groupings do not even assist in analysing the problems of farm organization in relation to the issues of efficiency and equity in Pakistan. Finally, and more importantly from the point of view of rural poverty, they do not reveal the impact of extraction of agricultural surplus for capitalist accumulation on each of the classes.

Source: Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985), 10–13.

Appendix 4.2

Transition in Pakistan's Agrarian Structure

The agrarian structure has undergone several changes since the early 1950s. Some changes reflect the effects of various tenancy and land reform acts, but most have been brought about by rapid population growth, laws of inheritance, new technologies and the forces of markets, rural to urban migration and flow of remittances, and government policies of support prices, inputs subsidies, and farm credit. Landownership, as shown by individual records, is still quite concentrated, although the concentration seems to have declined in every province.

The number of owners and the area of small landholdings (less than 5 hectares) has increased somewhat; the proportion of large landowners (more than 20 hectares) has gone down from 2.7 to 2.0 per cent and their share in the total area has declined from 26 to 23 per cent. In Pakistan, about 96 per cent of the landowners have holdings of less than 10 hectares, but they own 64 per cent of the area. The highest concentration of landownership is in Sindh. Small landowners (with less than 2 hectares) are preponderant in the NWFP (96 per cent) and the Punjab (80 per cent), but they own only 55 and 36 per cent of the area in the two provinces. They comprise 40 per cent of all landowners in Sindh and own less than 10 per cent of the area. The large landowners (with more than 20 hectares) own 38 per cent of land in Sindh, 20 and 14 per cent in the Punjab and NWFP, respectively.

Three major changes in landownership seem to have occurred since the late 1960s. First, the ownership and area under very small landholdings have increased mainly due to the subdivision of holdings by the law of inheritance and rapid population growth, though some of it may be the result of distribution of land to the landless following the land reforms of 1972. Second, there has been a significant fall in the number and area of very large landholdings due to the intra-family land transfers in anticipation of and in response to the Land Reform Acts of 1959 and 1972. Finally the medium-size holdings (10 to 40 hectares) have gained, especially in Sindh, both in number and area.

Of course, not all landowners cultivate their land, either their own or anyone else's, and not all cultivators own land. There are, therefore, several tenancy arrangements for cultivation purposes, of which the sharecropping tenancy and self-cultivation by (mainly small) landowners are the major forms. The access to land for cultivation is reflected in the distribution of 'operational holdings' or farms by size and tenure. The data on changes in the distribution of farms and farm area by size and tenancy have been published in the 1960, 1972, 1980, and 1990 Agriculture Census Reports. Generally speaking, Sindh has had the least concentration of farms due mainly to the widespread sharecrop tenancy; NWFP has been at the other end because of the preponderance of self-cultivation of small holdings as evident from Table 2. Note that land concentration has declined mildly in all provinces since 1960, but with some interesting changes during the period of 1960 to 1990. Apparently, land concentration fell significantly in the 1960s, but rose marginally in the Punjab and Sindh in the 1970s and substantially in all three provinces in the 1980s. These changes reflect a clear tendency towards reduced sharecropping tenancy and increased incidence of self-cultivation on all farm sizes.

The average farm size has declined from 5.3 hectares to 3.8 hectares, but the average size of large farms has increased. The number of farms has increased from about 3.75 million in the early 1970s to just over 5 million in the early 1990s. The share of small farms has increased slightly (from 67 to 71 per cent) in number but declined in area from 52 to 39 per cent. These changes reflect the large relative increase in the number and area of very small farms. While the share of large farms has fallen in number (from 11 to 7 per cent) their share in the area fell only slightly from 43 to 40 per cent. Tenurial arrangements seem to have changed significantly in the last thirty years. The proportion of owner-operated farms has increased significantly both in number and area. In fact, the owner-operated area has increased from just over one-half to three-quarters of the total farm area. Most of the owner-operated farms are small and located in the Punjab and NWFP. Sharecropping is still the major form of tenancy, especially in Sindh and some areas of the Punjab and NWFP. Sharecropped farms are in the range of 3 to 5 hectares, but they have declined sharply in both number (34 to 19 per cent) and area (from 30 to 16 per cent). A similar reduction has been observed in the case of 'owner-cum-tenant' farms, but large farms have been increasing. The tendency away from sharecropping is clearly reflected in the reduction of tenant-operated area from 46 to 26 per cent of all farm area. It seems that large landholdings dependent on tenants have also reduced their tenant-operated area.

The transition from the quasi-feudal to the capitalist mode of agrarian structure in Pakistan has made the land tenure system even more differentiated than it was before the 1960s. The capitalist farmers have emerged from the ranks of landlords and rich peasants. Labour is increasingly provided by landless workers, who could be from among the poor peasants (family farmers) and displaced or evicted sharecroppers as the landlords transform into capitalist farmers by extending their self-cultivated (khud kasht) area. However, not all of the landless labour is absorbed in the

Table 2
Changes in inequality in landownership and access to land 1950/1990

Year	Landowners and owned area				Operational holdings and farm area			
	Pakistan	Punjab	Sindh	NWFP	Pakistan	Punjab	Sindh	NWFP
1950	0.64	0.62	0.66	0.49	–	–	–	–
1960	–	–	–	0.62	0.59	0.51	[illegible]	–
1971/72	0.57	0.53	0.59	0.41	0.52	0.49	0.43	0.64
1976	0.55	0.52	0.58	0.41	–	–	–	–
1980/81	0.53	0.49	0.55	0.38	0.53	0.51	0.47	0.57
1990	–	–	–	0.57	0.53	0.50	0.61	–

Source: The data for landownership by holding size are from the Federal/Land Commission based on individual land records. The data for operational holdings (farms) and farm size are from the Agricultural Census Reports of 1960, 1972, 1980, and 1990.

Note: The ratios are the Gini Coefficients for landownership and access to land use.

capitalist sector of agriculture. Increasing numbers of unattached workers are either engaged in non-farming activities in the rural area or migrate from the village to towns and cities.

The gradual dissolution of the quasi-feudal and peasant systems has revealed several interesting features. In the landlord-tenant system, landlords have not entirely been in favour of evicting the sharecroppers on a large scale. This is partly to avoid legal problems which a large-scale tenant eviction could cause. The more important reasons are perhaps economic. Subsidized inputs, including tractors and other machines, since the late 1970s have raised private profits which the landlords are unwilling to share with their tenants. On the demand side, the structure of production has been changing in terms of cropping patterns in response to the growth of urban population, rising income levels and expanded export opportunities. Some landlords have, therefore, adopted the policy of sharing the cost of all modern inputs with sharecroppers, including those which have weakened the tenants' bargaining position by making the cost of animal power high to maintain. Also, landlords have expanded their self-cultivated area, mainly by reducing the size of parcel they give to each sharecropper. These policies increase the pool of dependent and relatively cheap labour without increased dependence on seasonal wage labour, the supply of which may be uncertain and costly.

In the peasant system, increasing involvement in non-farming employment and migration of part of the household labour have become a necessity for the poor and even middle peasants since they bring additional income for survival. Non-agricultural incomes, particularly remittances from outside the rural area, have also become a source for acquiring additional land which can be leased or bought from the poor peasants (small landowners) who cannot evidently survive on their incomes from the small plots they own. Addition to one's landholding means increased chances of survival in farming, with reduced vulnerability to competition from rich farmers, or even of joining the ranks of capitalist farmers. The peasant system at the lower end has probably thus extended its life-span and remains a contending force to the rapid development of capitalist agriculture in Pakistan.

The growth of wage labour is an indicator of changes in the agrarian structure. Despite the decline in the proportion of labour working in agriculture, from 60 per cent in the early 1960s to around 45 per cent in the mid-1990s, the absolute numbers are still rising. The level of demand for labour and the conditions of employment are directly affected by the organization and performance of the agriculture sector itself. Employment in agriculture is of two types: (i) self-employment as household labour on farms cultivated by small landowners and tenants, and (ii) hiring out of labour by the households of landless non-farming workers, tenants and small landowning peasants. Several significant changes have occurred in the composition and use of labour in the last twenty-five years. The use of family labour on small farms has not declined by much, but its use on larger farms has certainly fallen. While permanent hired labour was traditionally used mostly on large farms, fewer farms are now reporting its use. A high proportion of farmers now hire casual labour: its share in wage labour has increased from 30 to nearly 55 per cent. Pakistani farmers no longer depend entirely on family workers and most of them engage outside workers, at least for some of the time during the crop season. It is also a fact that an increasing proportion of the labour from farm households is engaged in non-farming activities on a short- or long-term basis because wage income from farming activities is insufficient to meet the growing needs of the family in a cash economy.

Source: Khan, Mahmood Hasan, 'Agricultural Development and Changes in the Land Tenure and Land Revenue System in Pakistan', in Khan, Shahrukh Rafi (ed.), *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999), 121–125.

NOTES

1. Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), 2.
2. Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985).
3. Ibid. 24.
4. Ibid. 24.
5. Ibid. 24.
6. Khan, Mahmood Hasan, 'Classes and Agrarian Transition in Pakistan', in Ali, Karamat (ed.), *Pakistan: The Political Economy of Rural Development* (Lahore: Vanguard, 1986), 446.

5 Agriculture: Critical Issues

In the previous three chapters, a history of the development of agriculture in Pakistan has been presented, where the focus has been on the changes that have taken place since the time of the Mughal Empire. So far, we have discussed how the process of change was initiated and the nature of that change. We have seen how, from pre-capitalist or feudal modes of production in agriculture, capitalist forms emerged and how they then established themselves, becoming the dominant form of production. In all of this story of agriculture, we have seen how economic and social relations have changed over time. However, while we have learnt a great deal about this transformation in agriculture, we have learnt nothing about what is grown, what actually constitutes agricultural production, and so on. This chapter will fill that gap.

We will first introduce the nature of agricultural production itself—crops grown, yields, area under cultivation, etc. The purpose will be to inform the reader about Pakistani agriculture and how it has changed since 1947. After a broad overview, salient contemporary issues related to agriculture will be introduced and discussed before we close this part of the book on the agricultural sector.

5.1 An Overview and Major Trends

The agricultural sector in Pakistan is classified as containing five subsectors: major crops, minor crops, livestock, fisheries, and forestry (see Figure 5.1). While the major crops make the largest contribution to the GDP from the agricultural sector as Figure 5.1 shows, their contribution has fallen considerably in the last thirty years. In fact, the fall in the contribution from major crops has been made up by an increase in livestock farming and production, or the 'white dairy revolution', as it is being called, where livestock's contribution has doubled in thirty years.

The rabi (winter) and kharif (summer) seasons divide the agricultural calendar. In rabi, the main food crop grown is wheat, with tobacco the largest cash crop. In kharif, cotton and sugar cane, both cash crops, are cultivated along with rice as the main food crop. Interestingly, it is the kharif season that provides Pakistan with its most important exports, cotton and rice, and hence floods due to excessive or prolonged monsoons can play havoc, not just with agricultural production, as they did in 2010 and 2011, but also with industry and exports. As we show in subsequent chapters, this has been the case many times in Pakistan's past.

The extent of change in Pakistan's overall economy and society over the last 65 years can best be summarized in a single figure which shows the extent of the contribution of agriculture to Pakistan's gross domestic product (GDP): in 1949/50, agriculture was by far the largest sector, contributing more than 53 per cent to GDP; in 2012, this share was down to only 21.1 per cent, i.e. less than even one-quarter. This is despite all the progress, growth, and development that was made in agriculture following the Green Revolution, and other salient milestones. While in 1949/50 agriculture contributed more than half of GDP, today the services sector contributes half, and is more than twice as large as agriculture. Another equally important statistic regarding agriculture is the fall in the share of the labour force employed in agriculture, from 65 per cent in 1950/1 to 45 per cent today, although agriculture is still the largest sector in terms of employment. However, rural areas now also have a large economic component called the 'non-farm' or 'non-agricultural' sector, which generates almost 60 per cent of total rural incomes, a significant development in the rural and agricultural sector in Pakistan.[1]

The total geographic area of Pakistan is 79.61 million hectares (or 196.64 million acres), and the 'reported' area in 2012 was 73 per cent of the total area (Table 5.1). (The reported area is that amount of the total geographical area for which official records exist. It has risen to 73 per cent today from 58 per cent in 1947/8.)[2] The non-reported area (27 per cent of Pakistan) for which records do not exist 'is due to large tracts of unsettled lands in most parts of the northern tribal territories in Khyber Pakhtunkhwa and in the north-western and western parts of Balochistan; some south-eastern and eastern desert areas in the Punjab and Sindh are also included'.[3] The fact that there has been an increase of 13 per cent in reported area since 1947 shows that larger areas and tracts of the land have become 'officially' part of Pakistan and are accountable for. This process is important for revenue records, inheritance and other purposes.

For agricultural purposes (and our analysis) the reported area is the relevant area. As one would expect, however, not all of the reported area is cultivable—in fact, in 2012 as much as 41 per cent of this area was not available for cultivation (Table-5.1 and Figure 5.2). In 1948 this proportion was 48 per cent, while in 1980/1, only 37 per cent of the reported area was uncultivable. This interesting trend is like a U-shaped curve, where the area not available for cultivation is very high in 1948, almost half of reported area, then falls, implying that more land as a percentage can be cultivated upon, and then rises again in the late 1990s. There are probably two very important reasons for this trend. Firstly, as we have seen in earlier chapters, following the commercialization of agriculture with Green Revolution technology, more land

Table 5.1
Land Utilization: 1947–2012 (in Millions of Hectares, with a Total Area of 79.61 Million Hectares)

Year	Reported area	Not available for cultivation	Total area cultivated	Area sown more than once	Total cropped area
1947/8	46.70	20.82	14.69	0.95	11.63
1960–1965	50.52	18.94	17.78	1.68	15.0[illegible]
1965–1970	52.98	19.08	19.19	1.99	16.28
1970–1975	53.53	20.50	19.21	2.54	17.04
1975–1980	54.27	20.62	19.84	3.30	18.44
1980–1985	56.29	21.29	20.32	4.09	19.68
1985–1990	57.87	23.97	20.78	4.79	20.49
1990–1995	58.04	24.49	21.17	5.70	21.86
1995–2000	59.12	24.51	21.90	6.37	22.83
2002/3	59.45	24.36	22.13	6.71	22.15
2000–2005	59.43	24.31	22.17	6.78	22.35
2005–2010	57.13	23.20	21.67	7.66	23.66
2010–2012^{P}	57.76	23.4	22.1	7.03	22.75

Note: ^{P} = Provisional

All figures are five years average except 2010–2012 (2 year average)

Sources: For 1947/8: Ahmed, Viqar and Rashmid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 110.

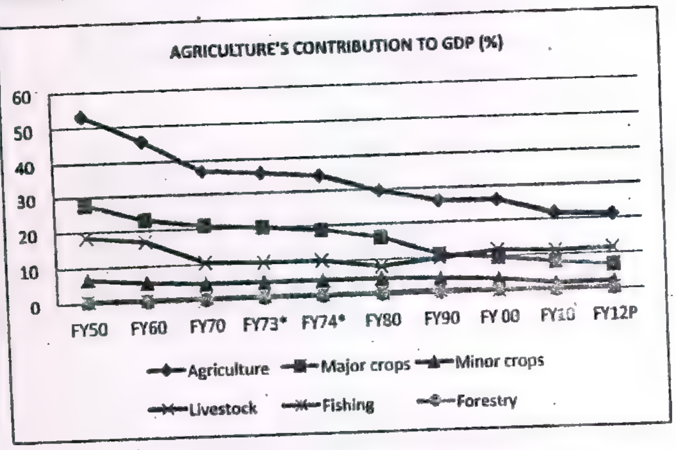
For other years: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

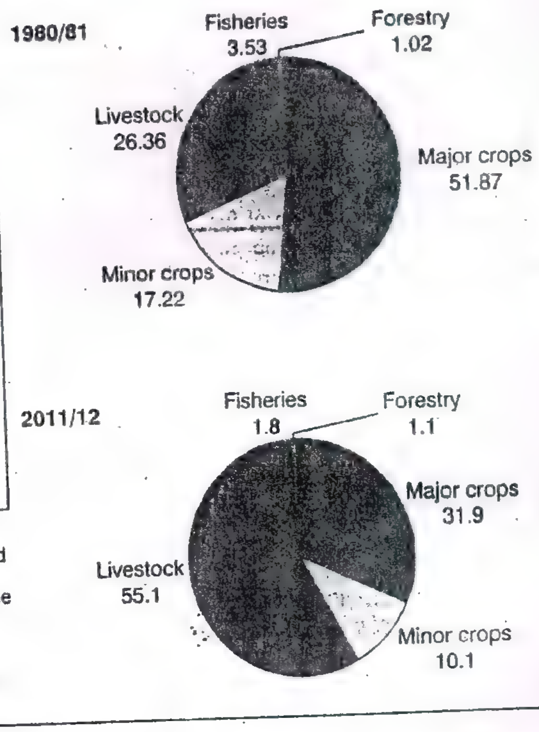
Figure 5.1
The Agricultural Sector

Five subsectors: major crops, minor crops, livestock, fisheries, and forestry

Share in agriculture's contribution to GDP (%)

	1949/50	1980/1	2002/3	2011/12
Major crops	52.0	51.87	40.64	31.9
Minor crops	12.5	17.22	15.90	10.1
Livestock	34.4	26.36	38.85	55.1
Fisheries	0.7	3.53	3.48	1.8
Forestry	0.5	1.02	1.13	1.1





Rabi (winter) crops: wheat, barley, gram, tobacco, rapeseed, and mustard

Kharif (summer) crops: cotton, rice, sugar cane, bajra, maize, and sesame

Food crops: wheat, rice, bajra, jawar, maize, barley, and gram

Cash crops: cotton, sugar cane, tobacco, rapeseed, mustard, and sesame

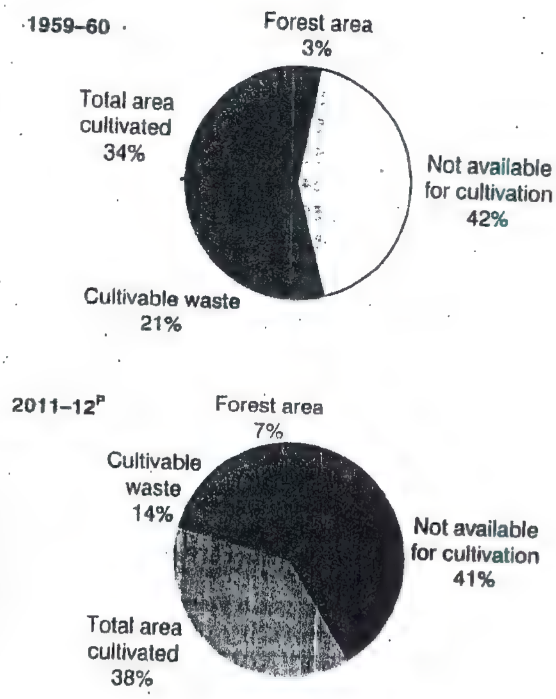
was brought into cultivation—this explains the increase in cultivable area. The fall in later years could be due to the faster increase in reported area compared to the colonization of new land. But since reported area has increased by only 20 per cent over the last five decades, compared to the 30 per cent increase in total area cultivated, this cannot be the case. The other reasons could be increasing urbanization, where urban land has been creeping on to agricultural land for the purposes of industry and residences, especially in the Punjab; or waterlogging and salinity, which is slowly eating away the land that was once cultivable. In the last decade, since 2000, it seems that there has been a far sharper rise in the process of transforming agricultural land into urban and semi-urban housing, resulting in further and growing urbanization.

Total cultivated area in Pakistan was 36.3 million acres in 1947[4] and 54.59 million acres in 2012. It was 32 per cent of reported area in 1947 and now constitutes 38 per cent. Table 5.1 provides basic data about land utilization in Pakistan. From the table we see that, as irrigation has expanded, so has multiple cropping (area sown more than once). In the period 1960–5 only 9 per cent of the total area cultivated was used for multiple cropping, while by 2012, this had risen to 32 per cent.

If we examine the data in Tables 5.2 to 5.7 regarding agricultural output and production, a number of interesting features are observed.

1. Table 5.2 shows that in terms of agricultural production, not surprisingly, all agricultural products have increased. With newer technology, more land available, increased demand both domestic and foreign, Pakistan's agricultural production has increased manifold. In Table 5.2 two sets of series with their base years in 1959–60 and 1999–2012 show that production more than tripled in many categories by the mid-1980s, and then compared to 1999/00 has increased by about 25 per cent in food and 'other' crops. Nevertheless, while there is much variation from year to year, it seems that in the last decade there has been an upward trend.
2. In Table 5.3 we see that the total area under food crops has increased by more than 50 per cent since 1959/60. Wheat is the largest sown crop and today constitutes 66 per cent of the total area of food grains, up from 60 per cent in 1959/60. For the four major crops of Pakistan, the area under wheat in this period is up 111 per cent, rice 160 per cent, cotton 116 per cent, and sugar cane 313 per cent. In the 1960–5 period, the four major crops covered about 53 per cent of total cropped area, whereas by 1995/6 this had increased substantially to 64 per cent, and in 2011/12 to 66 per cent. (see Figure 5.3 for changes in the relative positions of crops).
3. Total production shows that between 1950–5 and 2012 (Table 5.4) for all major as well as minor crops, there has been a very substantial increase—almost seven-fold—in total output over the last sixty-two years. Although overall output for major crops has increased, what is discerning is that the *rate of increase*, the average annual growth rate of major crops since 1980, had fallen, but has made a very marked increase over the last few years, particularly after 2010 for wheat and sugar cane, while rice production also rose after 2005. In the decade 1980–90, the average annual growth of major crops was 3.34 per cent, which fell to around 2.4 per cent in the 1990s. Both total production of wheat and rice fell sharply in the three years following 1999/00, as did production of all food grains. While lower rates of increases in output are a disturbing factor, so too is the instability and variability in output from year to year.
4. While increases in total area sown and total quantity produced are important in their own right, yield per unit of land (per acre or hectare) is a better indicator of how agriculture is progressing. Table 5.5 shows the average yields for major crops. Comparing the period 2012 with the early 1950s, wheat's yield is up from 776 kg/hectare to 2,774; rice is up from 878 to 2,218, although much of this improvement came in the early years; sugar cane is up from 29,180 to 55,000; and cotton is up from 212 to 770. This table, perhaps, best exemplifies the huge impact of the Green Revolution, where due to the high yielding variety seeds for wheat and rice there was a marked increase in output. For example, between 1960/5 and 1974/5, the yield for wheat increased by 59 per cent, and for rice by 55 per cent. Between 1974/5 and 2012, the

Figure 5.2
Land Utilization: 1959/60 and 2011/12 (% Use of Reported Area)



Note: P = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Table 5.2
Index of Agricultural Production: 1959–2012

Years	All crops	Food crops	Fibre crops	Other crops
1959/60	100	100	100	100
1960/1	100	98	103	103
1961/2	109	105	111	122
1962/3	119	108	128	151
1963/4	118	108	144	124
1964/5	128	120	130	162
1965/6	127	107	142	181
1966/7	135	114	156	189
1967/8	157	150	171	170
1968/9	168	160	180	184
1969/70	186	177	185	214
1970/1	174	164	188	195
1971/2	183	170	245	169
1972/3	188	181	243	163
1973/4	196	190	228	188
1974/5	187	183	220	171
1975/6	199	207	176	193
1976/7	203	212	149	224
1977/8	209	208	197	223
1978/9	219	238	162	212
1979/80	239	245	250	210
1980/1	249	254	245	236
1981/2	258	257	247	261
1982/3	270	277	283	235
1983/4	237	253	170	248
1984/5	275	265	346	239
1985/6	298	290	418	212
New Series				
1980/81	100	100	100	100
1986/7	124	115	185	92
1987/8	127	109	206	100
1988/9	134	118	200	112
1989/90	134	119	204	108
1990/1	142	122	230	110
1991/2	161	126	306	120
1992/3	141	124	216	118
1993/4	142	127	192	134
1994/5	152	138	208	140
1995/6	167	147	253	140
1996/7	158	145	224	130
1997/8	170	157	219	160
1998/9	171	159	210	166
1999/2000	191	180	268	143
2000/1	174	160	256	132
2001/2	172	153	253	146
2002/3	180	169	244	154
New Series				
1999/00	100	100	100	100
2000/01	93	91	95	94
2001/02	97	85	94	104
2002/03	104	92	91	112
2003/04	107	95	89	115
2004/05	104	106	127	102
2005/06	101	107	116	96
2006/07	117	115	114	118
2007/08	126	108	104	138
2008/09	114	124	105	108
2009/10	111	119	115	106
2010/11	119	120	102	119
2011/12^{P}	123	120	121	125

Note: ^{P} = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

yield for rice increased by 43 per cent, although the yields for wheat continued to show large increases, by as much as 121 per cent. However, it now took two decades to achieve what was achieved earlier in only one decade. Just as output has varied and been instable, so has yield per hectare. In the period 1990–2001, wheat's yield was up in only five of these eleven years, falling below the previous year's in six years; rice did only marginally better and improved on yield output in seven of these eleven years.

5. Table 5.6 shows how the sources of irrigation in Pakistan have changed over the last forty years. In 1950/1 canals provided 81 per cent of all irrigation, while in 2011/12 they provided 60 per cent. Tube wells, which were almost non-existent in the 1950s, now provide as much as 37 per cent of irrigation.

6. Given the rise in output and production over the last few years, one might assume that the people of Pakistan are better fed now than they used to be. However, the high growth in population might indicate that on a per capita basis they are not any better off. Table 5.7 shows that, in fact, since 1986/7 the per capita availability of the most important foods has varied a great deal. Wheat availability is below the 1986/7 level and considerably lower for rice. However, meat and milk production, indicative of the growth in the livestock sector, have increased considerably over the last 25 years. The rise in milk availability is indicative of the 'white revolution' which has taken place in the dairy sector in Pakistan over the last decade. However, this table should be taken as indicative only, for it does not show either distribution or the amount actually consumed. Availability may suggest production, but it does not take account of exports, losses, or actual consumption. Moreover, with high and rising food inflation since 2008, the ability to buy these food items becomes out of reach for numerous potential consumers who may shift to cheaper substitutes.

7. Figure 5.4 shows the overall annual growth rates in agriculture since 1949/50. We can see that growth in double figures took place in only three years, with negative growth in six. The highest growth achieved in any one year was 13.6 per cent in 1953/4–1954/5, with the lowest being –9.1 per cent, in the very early years. The trend seems to be more unsettled in the first fifteen years after 1949, and settles down in the mid-1960s. In the last three decades, there has been substantial year-on-year fluctuation in the growth rates of the agricultural sector, also having an impact on the economy overall.

While agriculture was the dominant sector of the economy in 1947, having a substantial share of employment and being the main contributor to GDP until about 1958, agricultural output and production stagnated, with the growth rate between 1949 and 1958 being only 1.43 per cent, which was less than half the growth rate in population. This meant that even the per capita consumption of food grain declined in this period. Food had to be imported and there was a heavy dependence on foreign aid and other hand-outs, many of which came with strong political overtones and consequences. It was possibly the realization of the need to

Table 5.3
Area under Major Crops: 1950–2012 (in '000 Hectares)

Year	Wheat	Rice	Sugar cane	Cotton	Percentage of total cropped area
1950–1955	4,154.0	947.0	245.6	1,275.8	–
1955–1960	4,736.6	1,078.8	365.4	1,393.2	–
1960–1965	4,896.2	1,214.2	447.6	1,375.4	52.59
1965–1970	5,591.8	1,426.6	559.0	1,635.6	56.58
1970–1975	6,017.4	1,514.6	597.6	1,860.2	58.62
1975–1980	6,272.0	1,797.6	747.0	1,916.4	58.20
1980–1985	7,174.4	1,984.2	859.8	2,177.7	61.96
1985–1990	7,418.2	1,986.6	833.0	2,459.6	62.26
1990–1995	8,058.6	2,099.0	927.4	2,758.0	63.32
1995–2000	8,306.6	2,333.8	1,029.8	3,002.4	66.21
2002/3	8,069.0	2,226.0	1,086.0	2,796.0	64.51
2000–2005	8,169.40	2,339.40	1,020.20	3,003.80	65.04
2005–2010	8,750.80	2,712.60	1,029.80	3,031.60	65.61
2010–2012^P	8,783.50	2,468.00	1,017.00	2,762.00	66.07

Note: ^{P} = Provisional
All figures are five years average except 2010–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

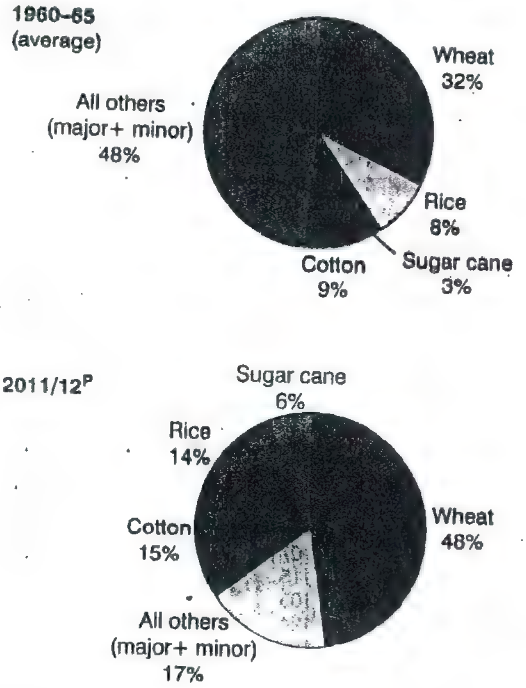
become somewhat less dependent on foreign money, and to make agriculture more profitable, which led to a number of very important interventions in the agricultural sector in the 1960s.

The land reforms of 1959 may have been a failure in terms of land redistribution (see Chapter 4), but they caused a significant shock to a moribund system. The Green Revolution technology was a critical factor in the impressive growth rates in agriculture achieved in the 1960s. Viqar Ahmed and Rashid Amjad write:

> Growth rates in the agricultural sector were significantly high in both the first and second half of the sixties. During the first half, the years of high agricultural growth were between 1960–1 and 1962–3 and then between 1963–4 and 1964–5. There was a marked slowing down during 1965–6 and in 1966–7. There was a very slow recovery in food crops in 1966–7 although overall agricultural growth was positive from a very low base of the previous year. The first significant year of the so called 'Green Revolution' is between 1966–7 and 1967–8 when agricultural growth increased by 11.7 per cent after which there were significant increases in the next two years especially between 1968–9 and 1969–70.[5]

The early 1970s also saw a second set of land reforms, which were much stricter in application, but did not produce the same results as the 1960s. Agriculture grew by a minimal 2.3 per cent between 1972 and 1977—well below the growth rate in population. While political uncertainty in the country may have caused overall production to be below historical trends, three of the five years of the Bhutto government had floods and pest attacks in which crops were severely

Figure 5.3
Total Area Sown: 1960–1965, and 2011/12^P (%)



Note: All other major + minor crops include: Bajra, Jowar, Maize, Barley, Gram, Rapeseed, Mustard, Sesamum, and Tobacco
^{P} = Provisional

Table 5.4
Production of Major Crops: 1950–2012 (in '000 Tonnes)

Year[a]	Wheat	Rice	Sugar cane	Cotton (000 bales)
1950–1955	3,235.8	837.2	7,192.6	–
1955–1960	3,677.6	909.6	10,318.6	–
1960–1965	4,016.4	1,107.8	14,247.8	1,995.8
1965–1970	5,175.6	1,512.6	20,718.0	2,625.0
1970–1975	7,145.6	1,929.2	17,402.8	3,705.0
1975–1980	8,765.0	2,778.2	26,743.0	3,094.0
1980–1985	11,330.6	3,292.8	32,651.6	4,926.6
1985–1990	12,947.2	3,232.2	31,973.4	7,632.6
1990–1995	15,724.0	3,412.0	40,901.6	9,648.4
1995–2000	18,238.0	4,487.0	48,371.0	9,837.0
2002/3	19,235.0	4,478.0	52,049.0	10,211.0
2000–2005	19,509	4,607	48,873	11,174
2005–2010	22,575	6,077	52,549	12,453
2010–2012[P]	24,366	5,492	56,674	12,528

Note: [P] = Provisional
All figures are five years average except 2010–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

damaged, resulting in low output. The government wanted to follow a pro-agricultural policy by devaluing the rupee, so as to increase agricultural exports, and by increasing the support prices of agricultural commodities. However, inclement weather ensured poor output. The late 1970s and 1980s witnessed a return to an overall healthy growth rate in agriculture despite a few noticeably bad years.

Before we turn to specific issues, it is worth looking at one theory which examines how output and productivity in agriculture are affected over time. Rashid Faruqee of the World Bank, used analyses developed by Derek Byerlee, who divided the growth in output due to technical change in countries like Pakistan into four stages. Rashid Faruqee described these stages as follows:

> (1) the pre-Green Revolution phase, when growth is driven by (irrigated) area expansion, and productivity growth is modest, (2) the Green Revolution phase, when growth is driven by high yielding varieties with increased responsiveness to inputs, (3) the first post-Green Revolution phase, when growth is driven by intensification of input use, especially chemical fertilizer and irrigation water (which facilitates multiple cropping), and (4) the second post-Green Revolution phase, when input use begins to plateau, and the source of growth becomes increases in input efficiency, coupled with the ongoing release of new varieties. According to this framework, the Green Revolution shifted the production function upwards and raised the marginal responsiveness to inputs. Farmers did not operate initially on the production frontier. In the first post-Green Revolution phase, use of complementary inputs rose and farmers improved allocative efficiency (equalizing marginal products and prices). In the second post-Green Revolution phase, farmers encountered diminishing returns to inputs, and moved towards the production frontier by raising their efficiency. Resource degradation is a form of technical regress which would shift the production function downward.[6]

Table 5.5
Yield of Major Agriculture Crops: 1950–2012 (Kg/Hectare)

Years	Wheat	Rice	Sugar cane	Maize	Gram	Cotton
1950–1955	776.6	878.4	29,180.0	–	–	212.0
1955–1960	782.2	846.8	28,240.0	–	–	212.0
1960–1965	831.8	929.6	33,580.0	–	–	254.6
1965–1970	977.0	1,507.6	37,840.0	–	–	289.4
1971–1975	1,251.0	1,549.0	35,508.0	1,160.0	544.0	346.0
1975–1980	1,454.0	1,569.0	37,038.0	1,249.0	486.0	284.0
1980–1985	1,596.0	1,684.0	37,460.0	1,267.0	476.0	343.0
1985–1990	1,773.0	1,600.0	39,574.0	1,339.0	514.0	544.0
1990–1995	1,950.0	1,623.0	44,000.0	1,407.0	452.0	594.0
1995–2000	2,194.0	1,919.0	46,887.0	1,657.0	614.0	557.0
2002/3	2,384.0	2,012.0	47,927.0	1,812.0	615.0	621.0
2000–2005	2,384	1,967	47,877	2,043	589	631
2005–2010	2,579	2,234	50,989	3,270	581	699
2010–2012[P]	2,774	2,218	55,734	3,875	374	770

Note: [P] = Provisional
All figures are five years average except 2010–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Table 5.6
Area Irrigated by Different Sources: 1950–2012 (in Millions of Hectares)

Year[a]	Canals	Tube wells	Others	Total
1950–1955	7.77	0.03	1.81	9.42
1955–1960	8.64	0.09	1.51	10.25
1960–1965	9.03	0.39	1.63	11.05
1965–1970	8.92	1.02	2.31	12.25
1970–1975	9.24	2.27	1.22	12.72
1975–1980	10.29	2.82	1.08	14.18
1980–1985	11.42	3.07	0.96	15.53
1985–1990	11.48	3.88	0.82	16.18
1990–1993	12.05	4.29	0.56	16.90
2001/2	14.05	3.48	0.51	18.04
1995–2000	7.69	2.98	0.19	10.85
2000–2005	7.01	3.42	0.21	10.64
2005–2010	6.89	3.79	0.29	10.97
2010–2012[P]	6.40	3.92	0.18	10.50

Note: [P] = Provisional
All figures are five years average except 2010–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

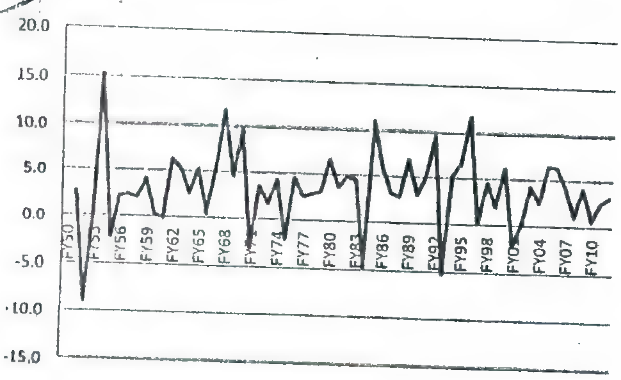
Table 5.7
Per Capita Availability of Main Food Items: 1986–2011 (Kgs/Annum)

Year	Wheat	Rice	Meat	Milk
1986/87	112.11	20.22	12.15	56.86
	100	100	100	100
1990/91	115.18	16.36	13.90	60.93
	103	81	114	107
1994/95	122.46	10.55	16.51	66.07
	109	52	136	116
1999/00	131.45	20.78	14.23	82.40
	117	103	117	145
2000/01	113.79	15.91	14.42	82.92
	101	79	119	146
2001/02	118.51	13.97	14.45	83.14
	106	69	119	146
2004/05	113.42	12.77	14.84	85.49
	101	63	122	150
2009/10	125.89	13.34	17.27	117.15
	112	66	142	206
2010/11[P]	109.98	12.13	16.76	118.6
	98	60	138	209

Note: [P] = Provisional
Source: Figures 2000/01 and 2004/05: Government of Pakistan, *Agricultural Statistics of Pakistan 2004–05*, 2006.
Figures 2009/10 and 2010/11P(ss) Government of Pakistan, *Agricultural Statistics of Pakistan 2010–11*, 2012.

This scenario seems to fit Pakistan, which is now, according to Rashid Faruqee, in a second post-Green Revolution phase, where input efficiencies are seen to be the main sources of growth now that high yielding variety seeds have been extensively disseminated and the use of irrigation and fertilizer is levelling off. While in the past, land expansion, multiple cropping, liberal availability of water, and a technical package were responsible for high growth in agriculture, for Rashid Faruquee, 'future growth must rely almost entirely on efficiency gains, the potential for which is considerable'.[7] For the World Bank, these efficiency gains arise through, amongst other mechanisms, output prices that are 'market determined', where the government does not 'distort prices', ends all forms of directed credit, and introduces a large number of institutional reforms. The significant increase in support prices by the Pakistan People's Party government 2008–13, which resulted in farmers receiving far higher prices for their produce—wheat's price was doubled from Rs. 425 in 2006/07 to Rs. 950 in 2008–09, while Basmati rice rose from Rs. 460 in 2005/06 to Rs. 1,250 in 2009/10, with IRRI rice also doubled—vindicates the claim that farmers are rational and respond to price incentives. The jump in food production—as well as domestic food prices for consumers, of course—after 2009, despite the extensive floods in 2010 and 2011, is indicative of these incentives. See Appendix 5.1 for the World Bank's view on Pakistan's agriculture. Some other recommendations as part of the Structural Adjustment Programme can be seen in Appendix 5.2 and Chapters 16 and 17. The next sections discuss some of these issues.

Figure 5.4
Average Annual Growth in Agriculture: 1949–2012



Source: State Bank of Pakistan, *Hand book of Pakistan's Economy* (Karachi: SBP, 2012) and Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

5.2 Agricultural Pricing Policy

As the last paragraph indicates, and as we have seen in Pakistan over the last five years since 2008, government can play a critical role in determining what, and how much, to produce through its pricing policy. Along with the right types of seeds, water, fertilizer, and other inputs, as well

as a package of technology and credit, the pricing policy of agricultural inputs and outputs can determine the direction of agricultural productivity and produce. Agricultural pricing policies can also impact significantly on income distribution, with particular reference to the incomes of small farmers. The consumer boom noticeable in Pakistan's rural areas since 2008/09, is proof of the fact that higher prices for farmers, despite inegalitarian land holdings such as Pakistan's, can have a positive impact on the overall rural economy, simply by giving the right price incentives. They can also have a noticeable effect on industrial productivity, urban wage goods, exports, and the cost of living, determining the terms of trade between agriculture and other sectors. Higher prices for agricultural commodities which might mean higher incomes for farmers, also translates to higher prices for urban consumers, a fact also noticeable in Pakistan in recent years. A good agricultural pricing policy can be defined as one where, *ceteris paribus*, price acts as an incentive to produce certain goods in required quantities (see Box 5.1). This, however, has not always been the case in Pakistan, and agricultural prices have been used for various purposes by different regimes. Appendix 5.3 shows how support prices for agricultural commodities were determined.

The comprehensive report of the National Commission of Agriculture (NCA) in 1988 examined the issues around the agricultural pricing policy of the first two decades following 1947, and had this to say:

> In the beginning, Government's main concern in regulating agricultural prices was to keep the cost of food low for the urban industrial workers and provide cheap raw materials for domestic industries. The objective was to enhance international competitiveness of the infant industries by maximizing the so called 'labour' advantage. The main features of the Government trade and pricing policies during the period up to the mid-sixties were as follows:
> a) Government fixed retail consumer prices of foodgrains at low levels which had the effect of depressing market prices for producers. Studies show that during this period the domestic prices of foodgrains remained consistently below the international parity prices calculated at the equilibrium rate of exchange.
> b) Heavy export duties were levied on cotton which had the effect of reducing domestic prices of cotton for the benefit of the local textile industry.
> c) Monopoly procurement of wheat and rice was resorted to at fixed prices which were deliberately kept low in order to minimize subsidies to consumers. Producers often sold to merchants at lower than the Government prices in order to receive prompt cash payments.
> d) Inter-district and inter-province restrictions of movement were imposed with the result that producer prices were depressed in the surplus producing areas.
> e) Prices of vegetable ghee were controlled at an artificially low level which had a depressing effect on producer prices of seed cotton and oilseeds like rapeseed and mustard.
> f) Proceeds from the agricultural exports were converted at an overvalued fixed exchange rate. The implicit exchange tax on agricultural exports from 1960 to 1971 averaged 89 per cent. In contrast, the industrial sector benefitted from the overvalued exchange rate which reduced the domestic cost of imported machinery and other inputs. When it came to the industrial exports, the exchange losses were offset by bonuses and subsidies. This heavy protection of the industrial sector at the cost of the agricultural sector failed to produce an efficient and viable industrial base for the economy. It rather became the cause of the dismal performance of the sector despite its highly privileged position.
> g) For nearly a decade after independence no systematic attempt for the development of agriculture was made. The first agricultural development programme in the country was launched in 1955.
> h) Barter deals were a common feature of Pakistan's international trade in which agricultural produce was exchanged for industrial machinery and inputs to the disadvantage of the agricultural producers.
> i) Government freely accepted the agricultural commodity imports at concessional prices which, when converted at the overvalued exchange rate, resulted in depressing the domestic prices. The adverse effect of the imported commodities was further intensified by budgeted subsidies given by the Government on their local sale prices.[8]

It is not surprising that, due to the above policies, agriculture suffered and was seen as a means to subsidize industrial production and urban consumers—part of the pro-industrial strategy which was heavily biased against agriculture. As the NCA Report argues, 'the implied objectives of the pricing policies during the period 1960–5 were to provide low cost food to the urban consumers, to provide cheap raw materials for the domestic agriculture-based industries, to keep wages of industrial workers low by supplying cheap food, and to transfer resources from agriculture to the urban sector for investment in industries and other non-farming activities'.[9] Clearly, these policies were not focused on improving and expanding agricultural output.

For some strange reason, it was assumed that farmers would not be price sensitive and would produce at their most efficient and best output regardless of the prices received by them. Policymakers assumed that 'low prices resulting from compulsory government procurement or high export duties on agricultural products would not affect the output level'.[10] However, the dismal conditions in agriculture prior to the Green Revolution forced the government to reconsider its approach to the agricultural sector, and along with the technical package, new pricing policies were also introduced so as to encourage agricultural output. Viqar Ahmed and Rashid Amjad argue that 'a recognition of the role of prices in agricultural development did provide much needed incentives to the growers, and may have partly contributed to the high growth rates in the late sixties'.[11]

Box 5.1

The Objectives of an Agricultural Pricing Policy

The study by the National Commission of Agriculture argues as follows:

> Pricing of agricultural inputs and outputs would be a major element of the dynamic agricultural policies necessary to achieve national targets of agricultural production. The Government should pursue an active price support policy seeking to consolidate the gains in four major commodities achieved in the last few years, making the policy fully effective for minor crops including oilseeds and extending the policy to cover more products as found necessary. The pricing of inputs and outputs should be closely coordinated keeping in view the following objectives:
>
> i) Carefully devised price signals can promote a balanced increase in production of agricultural products so as to fulfil domestic consumption requirements; increase earnings of foreign exchange through exports of products like cotton, rice and horticultural products, and save foreign exchange expenditure by reducing dependence on imports of agricultural products, especially edible oils, milk, and sugar.
>
> ii) Gradually rising but stable prices can create a suitable economic and psychological framework for positive response from producers to production incentives and move to the desired cropping patterns.
>
> iii) The Price Policy should help to achieve and maintain equitable terms of trade for agriculture and support the incomes of farmers.
>
> iv) It should help maintain stable food prices for consumers.
>
> v) It should keep domestic prices of export commodities and potential exports largely in line with the international prices to maintain competitiveness of agricultural commodities and minimize subsidies.
>
> vi) It should encourage larger investment in agriculture, especially in production of the products in which the national targets call for major increases in production.
>
> vii) It should encourage increase in agricultural productivity and reductions in production costs by promoting the use of better technologies and other non-price measures.

Source: Government of Pakistan, Ministry of Food and Agriculture, *The Report of the National Commission on Agriculture* (Islamabad, 1988), 490–1.

Viqar Ahmed and Rashid Amjad present a more holistic view of agricultural prices. They write:

> The determination of the prices of agricultural crops by the government, along with other administrative and economic controls on their processing, distribution and export, amount to the suppression of the market mechanism. But markets in Pakistan, as in other developing countries, are hardly perfect. Imperfections in the form of under developed transport and communication facilities, a high degree of heterogeneity among both the buyers and the sellers, and the division of the market into small isolated sub-markets, make the market system incapable of generating a substantial degree of competition. The farmers belong to a highly differentiated structure of interests in land, ranging from sharecroppers and tenants to owner-cultivators and still further to capitalist farmers and absentee landlords. Most farmers have little contact with the market either because they are subsistence owner-cultivators without a marketable surplus or because they are sharecroppers whose surplus is taken away by a non-cultivating class.
>
> State intervention under these circumstances is essential in order to create a mutually accommodating price-structure. This could allocate land and other resources among competing crops and also reconcile prices of agricultural output with the overall cost structure within agriculture. Inter-sectoral terms of trade between agriculture and other sectors also need to be maintained at levels which would eliminate causes of social frictions and distortions in development priorities.
>
> It is quite obvious that in the foreseeable future the agricultural price policy will have to be framed in such a way so as to achieve conflicting objectives like incentives for the farmers, stability of the urban cost of living, easy domestic availability of food grain and industrial raw materials, and adequate exportable surplus. In addition, small cultivators, including subsistence farmers, have to be given access to new inputs and technology and also to the benefits of the subsidy programmes so that these large public outlays do not become the cause of widening social disparities. . . .
>
> . . . What is required in this situation is to look beyond subsidies as a policy instrument, and to pay serious attention to such matters as improving the overall supply position of the inputs, particularly such divisible inputs as seeds, fertilizers and pesticides, and to ensure their timely availability. Attention should also be paid to the extension of rural outlets, the encouragement of multiple market channels, and the improvement of the farmers' ability to make efficient use of the inputs. As the supply position improves, it would be easier to reduce the subsidy level and to allow prices to rise gradually. If the farmer has access to institutional credit and is able to increase his net returns, an increase in input prices may not inhibit his demand for them.
>
> There is also a need to gradually raise output prices so that resources now tied to consumer subsidies are released for other purposes on the one hand and, on the other, the farmer can confidently look forward to larger cash flows and can plan his investments for a longer period than one or two crop seasons. It is imperative that the price signals sent to the farming community should be unambiguous and have a certain amount of continuity.
>
> Finally, an agricultural price policy by itself cannot necessarily serve as a grand design for major institutional or technological changes. It can serve limited goals and its success will depend upon it being supplemented by coordinated efforts in other related areas. It can heighten the effectiveness of various other tools of economic policy rather than become a substitute for them. In other words, it can function as a 'fine tuner' and not as a 'prime move'.

Source: Ahmed, Viqar, and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 154–5.

The first steps that the government took in this direction to encourage agricultural production was to begin to subsidize inputs, and not to raise the support or procurement price of output. During the 1960s and 1970s, an extensive structure of agricultural input subsidies was evolved which covered fertilizers, seeds, plant protection, tube wells, and agricultural machinery. Viqar Ahmed and Rashid Amjad believe that

> the objective of subsidizing inputs was to provide greater production incentives and to encourage the use of superior technology. It has been argued that while high output prices may or may not lead to greater investment in better technology, and may be diverted to higher consumption, subsidization of inputs, which comprises the new technology, would ensure its rapid adoption.[12]

The main beneficiaries of the subsidized inputs were those who most used these inputs, i.e. large farmers. As we saw in Chapter 3, the HYV technology and package were heavily biased towards the larger farmers. Hence they were the main beneficiaries, rather than the small and medium farmers who, due to numerous constraints did not make much use of modern inputs as well as water, credit, and agricultural extension services. For these reasons, some observers felt a need to 'look beyond subsidies as a policy instrument, and to pay serious attention to such matters as improving the overall supply position of the inputs . . . such as seeds, fertilizers, and pesticides and to ensure their timely availability'.[13] It was as late as 1981, when the Agricultural Prices Commission was established, that there was greater realization of the relevance of agricultural output prices.

The government introduced the concept of a minimum price support programme, which shielded the farmers from severe fluctuations in international prices and ensured a minimum return to producers. In the past, producers have received market prices well above the support price. The support price also acts as an incentive to produce more, as it is related to higher than average productivity. The National Commission on Agriculture (NCA) argued that 'the main role of the support prices is to protect the producers from a drop in the producer prices below the minimum level at which production remains profitable for good producers'.[14] However, serious problems and issues arise when there is a negative impact on farmers on account of high support prices. If world prices for food are rising, as they were after 2008, it makes sense to also increase the domestic support price, something that happened. But what does the government do if international prices fall, as they did in 2011 and 2012? It makes sense to subsidize and protect domestic farmers under such conditions, but consumers end up paying more for food which could be imported at cheaper prices on the international market. Clearly, these are politically sensitive choices and decisions are made taking into consideration the relative power of lobbies and vested interests.

A theme that will recur in this book is the major changes that have taken place in Pakistan since 1988 when the government made the first of its major agreements with the International Monetary Fund (IMF) and the World Bank. Pakistan actively followed a Structural Adjustment Programme (SAP) after 1988 under agreements with both these organizations. While an entire section of this book (Part VI) has been set aside for discussion of this theme, in the present chapter we will examine some of the issues that relate the Structural Adjustment Programme to agricultural issues, such as pricing policy and taxation (see Appendix 5.2 for a more detailed outline of the Structural Adjustment Programme).

In its 1988 report, which became the precursor to the actual Structural Adjustment Programme agreements (see Chapters 16 and 17), the World Bank's opinions regarding subsidies to the agricultural sector were expressed clearly. The World Bank stated that, 'fertilizer subsidies should be eliminated in line with government plans, wheat subsidies reduced further, and edible oil and sugar subsidies kept from reappearing'[15] (see Box 5.2 for an analysis of the problems with the wheat and fertilizer subsidies). In its evaluation of the first major Structural Adjustment Programme 1988–91, the World Bank report argued as follows:

> Over the adjustment period, Government has made progress in reducing price distortions by adjusting administered prices and in some cases liberalizing the markets in question. Output prices of agricultural commodities have generally been brought closer to farm/gate export/import parity levels, thus reducing the implicit tax on the agricultural sector. However, movement in this area has been limited and the current situation still induces a misallocation of resources in the agricultural sector. For example, farm prices for rice remain below international prices, creating disincentives to grow a crop where Pakistan has a strong comparative advantage. The same applies to wheat where domestic prices remain below import parity. Moreover, the Government did not adjust the issue price in FY92 [1991/2] despite a sharp increase in the import price. As a result, the consumer price subsidy increased sharply, reversing the progress achieved in earlier years. On the other hand, Pakistan has no comparative advantage in sugar cane. An adjustment of sugar cane support prices would induce farmers to increase yields or to shift to cotton, rice or wheat production. With regard to agricultural inputs, subsidies on pesticides, seeds and agricultural machinery have been eliminated. During the last three years, formal control over the price of nitrogenous fertilizer (urea) has been lifted and prices of phosphatic and potash fertilizers have been adjusted upwards so as to bring them closer to the (declining) international prices.[16]

Hence, on the advice of the World Bank and the International Monetary Fund, under the terms of the Structural Adjustment Programme, many subsidies were eliminated and domestic prices were freed to come at par with international prices. This practice has continued since 1988, and while some subsidies to farmers have been removed, far greater opening up of the domestic market for trade has taken place and prices have risen to encourage farmers. Procurement prices are set by government and are not 'free'. Moreover, numerous other

Box 5.2

How the Wheat and Fertilizer Subsidies Work

The World Bank has been a strong and consistent supporter of the free market and opponent of government intervention. It has advocated the removal of subsidies in almost all cases. About Pakistan it writes:

> *The wheat subsidy* in Pakistan, which dates back to independence in 1947, increased sharply in the 1980s. At its height (FY86), it reached Rs. 3.8 billion (4.2 per cent of current revenue), compared to just over Rs. 1 billion (2.1 per cent) in FY81. Following changes in the subsidy system in April 1987, the FY88 budget allocated about Rs. 3 billion for it, although the actual outcome may be higher.
>
> Under the current system the Government continues to procure wheat at a fixed price (presently Rs. 2.15 per kg) and stands ready to sell at the same price to private mills and other intermediaries as much as they require. The distribution cost and other incidentals, which are met from the government budget, currently result in a subsidy of Rs. 0.60 per kg wheat compared to Rs. 0.80 per kg prior to de-rationing; but could increase depending on the wheat harvest and the volume of procurement by the Government. The Bank recommends a phase out of this general subsidy within five years, and the substitution of a wheat subsidy limited to the needy. The present system is available to rich and poor alike, and benefits the urban population more than the rural population. Identifying the eligible population for a more targeted subsidy requires more administrative work. It could be achieved through specifically targeted compensatory programs for the poor and nutritionally vulnerable groups, such as food stamps; food distribution via health centers, clinics, schools and other welfare centers; and food-for-work schemes. At the same time, Government intervention in the wheat trade would be reduced. It would then regulate the market mainly through periodic interventions, via regulation of a strategic stock, and allow the private sector to perform the major market functions.
>
> *The fertilizer subsidy* has been an important element in the Government's policy to promote agricultural production by providing the farmer with low-cost imports. It has fluctuated between Rs. 1.5 billion and Rs. 2.5 billion a year since FY81, depending on the volume and prices of fertilizer imports, domestic production, and the Government's fertilizer price adjustments, which have usually fallen short of the increases in world fertilizer prices. In FY87, the decline in world fertilizer prices and deregulation of nitrogenous fertilizer prices in May 1986 helped reduce the subsidy to Rs. 2 billion. The FY88 estimate is Rs. 1.6 billion for phosphate and potash fertilizer subsidies, which are almost entirely imported.
>
> The Government has decided to phase out the current fertilizer subsidies through equal annual reductions of the current subsidy rate over a period of four years for phosphate (the principal type) and eight years for potash fertilizers. This is to be attained through annual price adjustments in line with international price trends; cost reduction measures in procurement, marketing, and distribution; and possible substitution of low-cost potash fertilizer imports. This programme will be supported by emphasizing farm-level adaptive research and extension services to raise the efficiency of fertilizer use. This phase-out, which the Bank endorses, is desirable for more than budgetary reasons. The fertilizer subsidy has now served its objective of educating the farmer in its use and benefits. The subsidy benefits particularly the large farmers since they have greater access to the complementary inputs. In addition, the Government's policy of deregulating agricultural output prices, combined with the setting of floor procurement prices at or above world prices, should provide appropriate incentives to agriculture without the fertilizer subsidy.

Source: World Bank, *Pakistan: Growth Through Adjustment*, Report No. 7118-PAK (Washington DC: World Bank, 1988).

constraints, such as having to sell mainly to the government, also act as a hindrance to farmers making higher profits. See Box 5.3 for why farmers prefer to sell at prices below the support price. Appendix 5.4, looks in more detail at the relation between prices and the boom in wheat production and the implications of this for farmers. Box 5.4 questions the whole notion of 'free' markets in Pakistan, given the critical role of the *arthi* and *beopari*. Box 5.5 questions the logic of raising wheat support prices, asking if this is bad economics.

5.3 Rural Financial Markets and Agricultural Credit[17]

There have been a number of studies and surveys conducted by different research institutes and by the State Bank of Pakistan which examine the nature and sources of rural credit. The main conclusions from these surveys are as follows:

> i) although there is a significant increase in the borrowing from formal sources from 1985 onwards when mark-up free loans were made available to farmers, these studies suggest that the principal source of farm credit continued to be the informal sources, especially for small farmers. A 1985 survey shows that 68 per cent of the credit to agriculture was provided by non-institutional sources while the 1972–73 survey had shown that 90 per cent of borrowing by farm households was from non-institutional sources. [Another study] demonstrate[s] from the 1985 credit survey that 85 per cent of the small farmers obtain their loan from non-institutional

Box 5.3

The Logic of Selling below Support Prices

Ali Salman explains the apparently irrational step of rice growers preferring to sell at below the government support price.

Like some other sectors in our economy, agriculture too is distorted by input subsidies and support prices. The government's interference, on pretext of powerful lobbies, reigns supreme and open market operations are absent. In this article I will discuss implications of support price for the rice crop which is currently being harvested. Instead of utilizing macroeconomic data let's take a look at a true story of a typical small grower in Punjab.

Like every year, the populist government has announced support price for rice growers. This year the erstwhile PASSCO (Pakistan Agriculture Supply and Storage Corporation) has offered Rs. 1,200 to Rs. 1,250 per 40 kg to rice growers. To find it out for myself, I made a special visit to my village in Central Punjab, where my family members, all of them small growers, had not only harvested the crop, but also encashed it. Instead of selling to their benevolent government, they decided to sell their crop to the open market through an 'exploitative' middleman. Outrageously, the open market offered them around 20 per cent less than what the government had announced, but using their free will, the growers still sold!

The following story narrates in detail why many growers decide to pick the low price of open market over high price of the government.

When the government announces support prices, it uses discriminatory methods to qualify certain growers by putting some conditions. The first condition is that the growers have to obtain a jute bag, called bar-dana, that is available only at government stores. In critical times however, as market fundamentals would predict, these bags vanish and are sold on the black market. The second problem is that even if these bags are available, they are not enough to cater to demand. Thus the growers either beg the inspectors to supply them sufficient bags or resort to agents to actually pay a commission to get these bags, which otherwise are 'free'. They are 'free' only as much as we want them to believe, otherwise they are paid by some of other taxpayers.

The second condition is that once the lucky growers, who receive sufficient quantity of bags, are ready to sell their produce, they will need to form a queue in front of government stores. They can wait and see numerous large growers, who can influence government inspectors, overtake them, and sell their produce. This process can take a couple of days. In the meanwhile the lack of adequate storage is a constant threat to his produce.

This extends his trial to yet another, third condition. The government inspector will inspect the quality of produce and is authorised to reject the lot. Once this rejection is announced, the grower, who had painstakingly arranged the jute bag and had waited for a good couple of days, has to go back. This means that he will now bear an additional transportation and storage cost. If he is lucky on his way back, he finds a 'self-interested' middleman, who offers him cash and purchases the produce, at a discount.

In the event the farmer is lucky enough to sell to the government, he won't get paid right away. The government stores do not carry cash! The farmers get a receipt and get paid in a few weeks time.

An intelligent, self-respecting, and business-savvy grower, especially small grower, which is the case with 90 per cent of our farmers, will always compare the out of pocket expense and the implied opportunity cost of resorting to the government support price. It is true that he is not literate by our standards, but he is very well educated about the economics of his livelihood. In fact, my typical farmer has already calculated an open market equivalent to support price. If the government price is Rs. 1,200, then after considering all the hassles mentioned above, the grower would be happy to sell his crop for Rs. 1,000, on ex-farm basis, against hard cash. Thus the open market keeps the prices under control and offers some respite to the struggling urban consumers.

There are several policy lessons from this true story. First, state intervention in commodity pricing, ostensibly done for welfare, is not only an economic but also political nonsense. A frustrated farmer in the presence of a support price is more belligerent than a struggling farmer in the absence of a support price. Secondly, when you curtail open markets, black markets emerge. The condition of carrying the produce in government provided jute bags should go. Thirdly, even the illiterate farmers can make rational and well-informed economic decisions, only if the all-knowing, benevolent government gets aside and vanishes.

Salman, Ali, 'Support price for rice: Why many growers prefer to sell for less', *The Express Tribune*, Karachi, 28 November 2011

Box 5.4

Free Markets for Agricultural Produce? The *Arthi* and the *Beopari*

The Panel of Economists set up by the Government of Pakistan in 2010 examined numerous aspects of the economy. They also looked at agriculture and agricultural pricing in Pakistan.

The Problem

Agriculture Marketing Acts govern the regulation of the purchase and sale of agricultural produce (including livestock and poultry) through the institution of market committees. A licence is required from the provincial government to establish a market within a notified area and once the notification of the market committee has been issued no other market can be established in that area without prior approval from government. The government nominates the members of the market's oversight committee and maintains significant control over the inflow of resources and assets owned by the market committee. This arrangement also results in the lack of accountability of the committee to market users and key stakeholders.

Whereas a farmer can only sell his produce through a licensed commission agent or the *arthi* (in most markets the *arthi* also acts as the commission agent), anyone can participate in the auction as a buyer, i.e. buyers do not require a license to operate in a market. The commission agent gets a commission of 5 per cent (on fruits) to 8 per cent (on vegetables) on the produce sold in the auction.

The Committees have monopolistic power and control over the bulk/wholesale purchase and sale of farmer produce in the area that is traded in these markets. This is detrimental to the interests of growers, most of whom tend to be middle farmers—with the small landowner largely resigned to selling his entire produce to the '*beopari*' (contractor/middlemen/trader) who picks it up from the farm gate or to the *arthi* in the market.[1]

Over the years, however, commodities like wheat, rice, maize, cotton, sugar cane, and oil seeds are no longer being traded in these markets and are being sold directly to processors like ginners, rice husking mills, flour mills, and sugar mills.[2] Similarly, fruits and vegetables grown are being bought directly by middlemen/trader/contractor from the farms of the small farmers[3] and brought for sale in the markets under discussion or sold directly to large wholesalers who in turn either export the produce or sell directly to large retailers. Poultry is not being traded in these markets while local governments (largely since the devolution in 2001) and private entrepreneurs in complete contravention of the law (reflecting on its poor enforcement) have set up markets for livestock.[4] In other words, only fruits and vegetables (contributing 10–13 per cent of Sindh's crop produce, valuing around Rs. 30 billion at 2006/07 prices), but making up 40–45 per cent[5] of the total production of these commodities, find their way into the government controlled markets. If livestock is included as agricultural produce that has to be traded through these markets, then in the case of Sindh the provincial government exercises control over the trade of almost Rs. 70 billion of value added in agriculture.[6]

There are too many intermediaries in the marketing chain (as illustrated in Figure I below). As explained above the *beopari*/trader and the *arthi* provide the link between the farmer (and the commission agent in some instances) and the wholesaler. The wholesaler serves as the link between the *mandi*/market and the retailer. At each step the intermediary marks up the price to factor in his profit/'cost of service' making the supply chain inefficient. It is estimated that in Sindh the wholesaler marks up the auction price at which he bought the produce by 10–15 per cent (depending upon the commodity and the supply and demand situation) when he sells to the small wholesaler or retailer,[7] who in turn, when selling to the final consumer, mark-up the produce by an overall 20–40 per cent depending upon the commodity and its quality to account for spoilage, especially of perishable items and the consumer markets in which they are sold, the more up-market the locality the higher the mark-up for quality and the cost of operations. In other words, the intermediaries pocket two-thirds to three-fourths of the price paid by the final consumer. The process of price discovery is opaque and places the grower at a disadvantage. The number of intermediaries also contributes to overall wastage—the spoilage in this lengthy chain can be as high as 40 per cent of the total supplies of the farmer. The farmer and the consumer pay for these inefficiencies.

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1 A significant proportion of the input costs of a small farmer are financed by loans from the *arthi*/commission agent on the condition that the entire crop would be sold through him in the market.

2 However, the market committees try and collect market fees from the ginners, rice and sugar mills for the produce that they buy directly

3 It is widely believed that the small farmers have neither storage facilities nor the financial resources to transport their produce to the market. The *arthi* or the middleman/*beopari* is well positioned to exploit this weakness. Moreover, the price received by a farmer for his produce is influenced by prices for the crop in the government controlled markets which serves as a reference point for price formation.

4 However, there are no legal bars on the private sector setting up slaughter houses. Local governments are empowered to regulate the establishment and operations of these slaughter houses—essentially to ensure compliance with environmental considerations.

5 Sindh Government officials, however, challenge this claim. They argue that the volume traded through these markets is larger—in their opinion sales of 60 to 70 per cent of fruits and vegetables are transacted in these markets. Smaller quantities are being reported by market administrators simply to justify the total market fees of Rs. 70 million being accounted for officially—leakage being a major issue.

6 Assuming 25 per cent of the stock of buffaloes, cows, sheep and goats is slaughtered every year.

7 While 30 per cent of the produce is sold by the wholesaler on cash the balance is traded on a 10–15 day credit.

Figure I

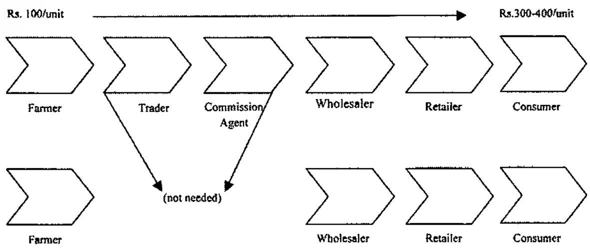


Figure Source: Khan, Mahmood Hasan, *Agricultural Growth in Irrigated Punjab: Some Issues and Policies*. Centre for Research in Economics and Business, Lahore School of Economics, 2008

Solutions

There is no reason why trade in fruits and vegetables and livestock cannot be deregulated by allowing private parties to set up and operate bulk/wholesale markets and manage product-grading and standardization processes. There is, therefore, a need for an enabling policy environment for trade in agricultural produce and market access by reducing trade barriers through the creation of more competitive, non-monopolistic structures that will ensure better returns to farmers.

Introduction of greater competition at the wholesale level will not only reduce congestion in markets but also enable farmers to increase their earnings with declining opportunities for extracting rent presently available to traders who have captured these government regulated market committees that have the sole right to conduct wholesale trade in the area and also only through government-appointed commission agents.

Although the legislation governs the orderly flow of farm produce to the consumer with price discovery through the auction process the farmer, especially the small landowner, is exploited by the *arthi* and the commission agent a) because of the monopoly they enjoy since the produce can only be sold in that particular market;[8] and b) through unfair grading and weighing of the produce. An amendment in the legislation or its repeal will open up opportunities for improving the farm produce supply chain—permitting retailers to buy directly from the farmer by-passing the markets and the intermediaries. Such an arrangement will enable organized retailing (e.g. Metro type organized retailers/wholesalers) directly sourcing from the farmer, eliminating at least two intermediaries from among the *arthi*, commission agent, and the wholesaler, with the need for central storage and reliance on wholesalers also being eliminated in the process.

We estimate that the overall economies from the shortening of the supply chain—with the reduction in the number of intermediaries would be 20–25 per cent of the consumer price in the case of farm produce. These economies would be a mixed blessing with varying impact on the different stakeholders, creating winners and losers. In case of farm supplies the share of each would be a function of their relative power and the situation with respect to competition, the greater the competition the higher the benefits that would accrue to the farmer and the consumer. Farmers will get higher prices and if warehouses and cold storages are constructed, spoilage of farm produce would be reduced significantly and provide an incentive to increase farm productivity through improved technology. The wholesalers would no longer have to buy from *mandis*/markets thereby lowering their purchase costs. The procurement costs of retailers would also be lowered with margins depending upon the competition between wholesalers and retailers. While some *arthis* and commission agents would be driven out of business they could harness their unique competency about market knowledge and contacts to reorient their businesses by for example becoming wholesalers.

Our estimates suggest that just for onions, chillies, bananas, and mangoes, whose traded value in these markets at their June 2008 retail prices in Karachi was respectively Rs. 6 billion, Rs. 2.5 billion, Rs. 5 billion, and Rs. 1 billion the overall annual economic savings from the shortening of the supply chain (including reduced wastage/spoilage) could be Rs. 1.5 to Rs. 2 billion at today's consumer price in Karachi.

The reforms in the area of agriculture marketing should also aim to strengthen market related information systems. There is a need to tackle information asymmetry on prices to enable farmers to maximize their returns without being exploited by middlemen on this account. To this end, there is a need to improve the information providing network comprising websites and electronic boards in markets to make data real time.

Source: Final Report of the Panel of Economists, *Medium Term Development Imperatives and Strategy for Pakistan* (Islamabad: Planning Commission, Government of Pakistan, April 2010), 62–64 and 66–67.

8. Since the function of the markets is price discovery and if farmers only get a third of the retail price in government markets that sets the base for all transactions.

Box 5.5

Wheat Support Pricing or Bad Economics?

Ahmad Fraz Khan asks the question whether anyone really benefits from raising wheat prices or not.

The Economic Coordination Committee of the cabinet has increased wheat support price yet again, third time over the last four years of the present government's rule. The last week's increase has taken the price from Rs. 1,050 per 40kg to Rs. 1,200 per 40kg—a jump of 14 per cent.

Last year, the price was taken from Rs. 950 per 40kg to Rs. 1,050 per 40kg—an increase of almost 10 per cent. In 2008, when this government took over, it increased the price from Rs. 625 per 40kg to Rs. 950 per 40kg—a leap of 46 per cent.

It is not only this government. The last one, when closing in on elections in 2007, had also increased price from Rs. 425 per 40kg to Rs. 625 per 40kg. This makes a little less then 300 per cent increase in the last five years. And this is being done to a crop that is a staple for the huge majority and dictates food security situation in the country.

Once the new wheat price takes hold of the market, the 20kg of flour, which used to cost Rs. 225 in 2007, would cost well over Rs. 725—taking it out of financial reach of a few million more. The social cost of political pandering of rural voters thus becomes unbearable for the people.

By increasing price of wheat every year, the ruling elite tries to consolidate its rural vote bank, thinking that all rural people would benefit.

This is, however, a wrong assumption if Pakistan Agriculture Census is to be believed. According to it, around 85 per cent farmers don't produce marketable surplus. Thus, they are not the beneficiaries of a regular increase.

To make the assumption even skewed, around 40 per cent of rural population is landless labour that buys wheat for survival. The increase thus benefits only a small part of the rural population that produces a marketable surplus and is part of the ruling elite and decision-makers who raise wheat prices for meeting its electoral expenditures.

The stated logic behind increasing wheat support price is the escalating cost of production. This growing cost is a reality but it constitutes one of the many variables that should determine the wheat price. Import and export parity, domestic consumption, and projected requirement should also get equal weight in calculating price. But it has not been the case, as electoral politics overrides everything else.

Increasing cost of production is a reality, one created by government policies. In the last four years, fertilizer (urea) price has increased from Rs. 700 per bag to Rs. 1,700 per bag—a difference of a staggering 142 per cent. Electricity prices have gone up by 163 per cent—from Rs. 3.28 per unit to Rs. 8.63 per unit. In the same period, diesel cost grew from Rs. 73 to Rs. 111 per litre—a growth of 53 per cent. All these prices increased mainly due to government policies and it is the major beneficiary of the increase. In fertilizer price, a small role is played by weakening government writ and cartels operating in it. Here again, it is the government that should take the blame.

Because of these factors, the cost of wheat production, according to official estimates, has increased from Rs. 400 per 40K in 2006–07 to Rs. 932 per 40kg (133 per cent). The farmers' bodies, however, put it at much higher figure. The government has created a vicious circle for itself, where it increases prices of inputs to meet its own running expenditures. Then, it increases wheat prices to compensate farmers. On the third plank, it procures wheat to stabilize market. Finally, it ends up subsidizing flour for the urban population. One wonders, where this process would stop.

The cumulative cost of these four stages is hundreds of billions of rupees a year. By increasing wheat price, the government only correspondingly adds to these expenditures. This is apart from regular reports of massive corruption at these stages that have become fodder for the media.

One indicator of this rising cost is administrative cost of wheat procurement. In the last four years, Punjab, which is one of three organizations (along with Sindh Food Department and Passco) involved in procurement, had paid Rs. 80 billion in interest payments to banks on its stocks. That makes it Rs. 1.66 billion a month or Rs. 550 million a day.

In 2009–10, the Punjab procured 5.78 million tons at the cost Rs. 143 billion and paid Rs. 19 billion in mark-up to banks. Next year, it borrowed Rs. 88 billion and paid Rs. 26 billion to banks as carryover stock kept adding to the cost. In 2011–12, it borrowed Rs. 76 billion and interest payments were Rs. 23 billion. This year, it still owes Rs. 73 billion and has so far paid Rs. 11 billion.

In these four years, the Punjab alone had to borrow Rs. 381 billion for wheat procurement and paid Rs. 79.53 billion to service loans. The other two—Sindh and Passco—also procure around the same quantity and cost can easily be doubled if they are added to the tally. This is the cost of increasing wheat prices regularly and dealing with the fall out.

The federal government needs to consider two options: controlling input prices instead of increasing support and leaving price fixation to provinces. Instead of increasing support price and increasing administrative and corruption charges, the federal government should adopt fiscal and taxation policies that bring input prices down.

This would benefit the small farmers in equal measure and add to their productivity. Secondly, the federation should now leave the prices of agriculture commodities, wheat included, to provinces, which now own the sector.

It sounds strange that producers should be deprived of the right to fix price of their products. Punjab, to its credit, opposed increase in wheat prices but the federation unilaterally did the deed, creating a situation for provinces where they have no option but to follow the price or risk alienating voters. This is certainly bad economics.

Source: Khan, Ahmad Fraz, 'Wheat support pricing or bad economics?', *Dawn*, Karachi, 3 December 2012.

sources compared to 40 per cent in the large farmers category;

ii) a significant proportion of loans (over 30 per cent) disbursed by institutional sources are either proxy loans or roll over funds.[18]

A 1995 World Bank study examining the extent and degree of rural finance in Pakistan reached the following conclusions:

1. Credit does play an important role in agricultural productivity and output.
2. Rural credit reaches few rural households, and institutional sources provide credit to only a small proportion of rural households. Only 32 per cent of all rural households take loans, and of these a mere 10 per cent borrow from institutional sources. The main sources of institutional credit are: Agricultural Development Bank of Pakistan (ADBP) which is now called the Zarai Taraqiati Bank Limited (ZTBL) 76 per cent, commercial banks 17 per cent, and co-operative societies 6 per cent. 90 per cent of the households take loans from informal sources, mainly friends and relatives (67 per cent) and landlords (11 per cent). Not surprisingly, non-institutional or informal sources of credit dominate the rural sector.
3. Both sources of credit tend to be short term, but serve different needs. For example, 94 per cent of institutional or formal credit is meant for production and investment, while most (47 per cent) non-institutional credit is used for consumption purposes.
4. Not surprisingly, there is an inverse correlation between wealth and access to sources of credit. Richer households in the rural areas have better access to institutional sources, which are also cheaper, while poor households depend primarily on more expensive, non-institutional credit (see Table 5.8).
5. The access by poorer households to institutional sources of credit is constrained by complex procedures, and informal sources are much simpler and more flexible, often requiring little collateral. As much as 76 per cent of formal institutional credit was against the security of landed property and 21 per cent against personal surety. For informal sources of credit, as much as 96 per cent of loans were advanced on personal surety. This may help explain why there is differentiation between institutional/non-institutional credit based on size of farm, and by ownership pattern. One would expect smaller farmers to access informal sources of loans more easily and frequently than larger farms, which would have better access to institutional sources. Moreover, owners would take out greater loans than tenants from either source (see Table 5.9).[19]

Table 5.8
Sources of Loans by Asset Quintile

Asset quintiles	Institutional		Non-institutional			
	Percentage credit	No. of loans	% credit from friends and relatives	No. of loans	% credit from other informal sources	No. of loans
Lowest	1.05	3	31.43	201	67.51	585
Second	4.83	13	49.53	249	45.63	396
Third	12.60	23	48.33	244	39.07	308
Fourth	29.62	52	35.44	174	34.95	285
Highest	58.36	116	20.10	139	21.54	263
All households	32.16	207	32.39	1,007	35.45	1,837

Source: World Bank, *Pakistan: Rural Finance for Growth and Poverty Alleviation* (Washington DC: World Bank, 1995), 9.

Table 5.9
Distribution of Institutional Loans as a Percentage of All Loans by Categories and Size of Farm: 1973 and 1985

Size (acres)	Owner		Owner-cum-tenant		Tenant		All cultivators	
	1973	1985	1973	1985	1973	1985	1973	1985
0–5	1.80	8.83	1.50	1.90	0.43	1.36	1.48	7.45
5–15	12.52	33.10	2.19	16.83	3.38	3.17	6.88	21.81
15–25	12.25	45.96	2.91	24.73	1.22	5.76	6.40	33.63
25–50	20.62	62.05	6.99	49.83	0.81	5.68	13.38	51.82
Over 50	31.15	65.18	24.92	57.20	21.02	16.24	29.00	61.31
All sizes	14.71	37.47	6.10	33.57	3.02	4.01	9.80	13.16

Source: World Bank, *Pakistan: Rural Finance for Growth and Poverty Alleviation* (Washington DC: World Bank, 1995), 61.

Recent studies have shown that little has changed some years on. In May 2009, a large survey and study was published by a number of institutions known as the 'Access to Finance Study'.[20] While some of the findings and features of this Report are presented in Chapter 14 on Banking, here we summarize some of the findings related to rural financial markets.[21]

1. Only 14 per cent of all Pakistanis, rural and urban, use a financial product or service of a formal financial institution, which includes savings, credit, insurance, and remittance services. However, around 50 per cent of all Pakistanis have access to some sort of financial service, whether from the formal sector or from the informal unorganized or informal organized sector. The organized informal sector comprises of committeees/*bisees*, shopkeepers, moneylenders, hawala (informal system of transfering money)/hundi (money remitted by a negotiable instrument) money transfers, and such like. The unorganized informal sector comprises of friends and relatives. Half of the population is excluded from any form of financial service, whether formal or informal. Compared with only 14 per cent of Pakistanis who are part of the formal financial sector, the figure for Bangladesh is 32 per cent, and 48 per cent in India, and as high as 59 per cent in Sri Lanka. Clearly, financial inclusion in the formal sector is very low compared to other countries in South Asia.
2. Rural areas account for only 10 per cent of the total bank deposits in Pakistan by value, and only 7 per cent of the total value of deposits and advances from banks. Only 15 per cent of farmers are reached by the financial system as a whole, including commercial banks, agricultural banks, and other financial institutions.
3. There is a very large imbalance in access to formal finance which favours large farmers. The upper-income large farmers have access to ten times the access to formal finance compared to the lowest quintile of farmers. This imbalance is also replicated in terms of informal sources of finance.
4. Since the formal sector is small and a large number of Pakistanis borrow, most, even in the rural sector, borrow from informal sources, such as family and friends and shopkeepers. Also, as Box 5.4 shows, many farmers also borrow from the middlemen in the chain of delivery and market. Most of those who borrow in Pakistan, do so for consumption smoothing purposes, such as household needs and marriages or funeral expenses. Nearly half of the households borrowed from friends and family, with around half borrowing from shopkeepers. Not surprisingly, nearly 98 per cent of the rural population, has never taken a formal bank loan.

The studies cited above confirm the view that irrespective of income levels, the rural population rarely uses formal financial services. Numerous reasons account for this, and include the absence of formal financial services close by, the paperwork, involved in setting up such accounts—it takes twice as long in Pakistan to open an account as it does in the rest of South Asia, and one presumes that in rural Pakistan, this might be longer still.[22]

5.3.1 Informal Sources of Credit

A study in the Punjab has shown that only 15 per cent of the small farmers had access to institutional credit, while a 1986 study in Sindh suggested that only 8 per cent of farmers had this source of credit available.[23] There were also numerous problems related to the availability of this meagre amount of credit. The need for credit at a particular time, like other inputs, can have a critical influence on whether a crop will succeed or fail. Studies have found that a disproportionate number of farmers (69 per cent in one study)[24] were given credit well after the deadlines had expired.

Although Table 5.10 shows the quantum jumps made in the amount of credit available to farmers through institutional sources, there is a very noticeable preference amongst users for credit from non-institutional or informal sources. The

Table 5.10
Agricultural Credit Disbursed in Pakistan by Agencies: 1955–2012 (Rs. m)

Year	ZTBL	Taccavi	Domestic Private Banks	Co-Operatives	Commercial Banks	Total
1955–1960	7.4	12.3	–	32.0	–	51.6
1960–1965	40.3	15.9	–	72.1	–	128.3
1965–1970	89.6	11.9	–	59.1	–	160.7
1970–1975	230.4	21.8	–	72.5	297.7	503.5
1975–1980	546.0	13.9	–	241.8	1,192.7	1,994.3
1980–1985	2,446.8	8.5	–	1,332.4	2,981.2	6,768.7
1985–1990	7,422.5	17.5	–	2,221.9	4,899.2	14,566.1
1990–1995	8,375.4	–	–	2,788.1	3,827.1	15,023.2
1995–2000	19,795.0	–	–	4,710.0	6,426.0	30,933.0
2001/2	29,108.0	–	–	5,273.0	17,486.0	52,446.0
2000–2005	30,666	-	4,281	6,182	27,368	67,640
2005–2010	65,031	-	33,869	6,222	94,677	199,799
2010–2012^P	51,603	-	43,763	6,587	123,976	230,192

Note: ^{P} = Provisional
All figures are five years average except 2010–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

reasons given for this include easier access, absence of cumbersome procedures, availability as and when required, the availability of credit even for consumption purposes or emergency loans, unlike official sources which have rather restricted uses of credit, the possibility of a deferred repayment of debt if crops fail, and often the availability of credit through informal sources without the need for any collateral.

A major complaint heard from farmers pertains to the high transaction costs that borrowers are forced to pay in order to acquire a loan. Transaction costs are said to comprise various components, including 'application fees, form-filling fees, loan registration fees, borrower's travelling expenses, costs of entertaining people who assist the farmer in getting the loan, and the opportunity cost of the borrower's time in negotiating the loan'.[25] In comparison, such non-mark-up costs are almost negligible when credit is borrowed from informal sources. Since many farmers feel that the difference in the total cost of borrowing from both sources is almost negligible, farmers prefer to acquire credit from informal, non-institutional sources.

Official government figures in the 1970s revealed that as much as 80 per cent of rural credit was supplied by informal leaders, but with the huge increase in formal credit, the expansion of bank services and greater monetization, there was a fall in this proportion to about 55 per cent by the early 1980s.[26] Box 5.6 contains the arguments for and against informal loan markets.

There is a belief that moneylenders in the informal market charge 'usurious' rates of return, but it has been observed in Pakistan that they are a disappearing breed; the main actors in informal rural financial markets are now the commission agents or arthis, and increasingly, shopkeepers, as consumer goods expand into rural areas. One needs to examine how the rate of return is determined in informal lending and to what extent this rate differs from the formal sector. Amongst the mechanisms that determine this return is the

> most obvious and visible mechanism [which] is the statutorily fixed commission on the marketed value of output. However, a large component of the return may consist of less visible mechanisms like manipulation of output purchase and input supply prices, biases in weighing of output, charging of fictitious costs, payments in instalments, etc. The issue is the extent to which reliance is placed on market imperfections and extortionary mechanisms to charge effectively high rates of return from borrowers.[27]

As Viqar Ahmed and Rashid Amjad argue, 'the very fact that a large number of farmers prefer to borrow from informal

Box 5.6

Are Informal Financial Markets Always Exploitative?

Different views exist about the nature of informal financial markets. Some are summarized here:

i) According to one view, informal lending is inherently 'exploitative' in character, with 'usurious' rates of return being charged from small farmers who find themselves in a state of perpetual indebtedness. In this view the informal credit market is fragmented, imperfect, and characterized by local monopolies. Consequently, rates of return are high, ranging from 30 per cent to 50 per cent. Various mechanisms exist for extracting a high rate of return on loans which include lower prices for output marketed to the lender (commission agent), higher prices for inputs, biased weighing of output, charging of fictitious costs, etc. Consistent with this view of informal lending is the policy prescription that institutional finance is essential to get the small farmer out of the clutches of these exploitative arrangements.

ii) Various authors have also highlighted the constraints of informal lending which have inhibited its growth. They have indicated that resources and activities of informal lenders are inadequate and ill-suited for modernization. This is largely due to their inability to lend for long enough periods for farmers to acquire productive assets. Hence, the growth of informal lenders has been slow. Another failure has been the lack of mobilization of financial deposits because deposit facilities are inadequate, unsafe, untrustworthy, or less remunerative.

iii) The other sharply contrasting view of informal lenders was first articulated by Michael Lipton. He argued that there should be greater reliance on informal sources which do indeed get to poor farmers, albeit at high rates of return. As opposed to this, concessionary institutional finance is largely siphoned off by large farmers. Also, informal lending has a number of inherent advantages. It is potentially more efficient, decentralized, and accessible, loans can be obtained on time, and scope exists for receiving consumption loans for financing emergency needs along with production loans. It has been shown that the difference between costs of borrowing from formal and informal sources is greatly diminished if transaction costs are included. . . . In Bangladesh effective costs [mark-up + borrower transaction costs] of small loans from informal sources are, in fact, lower than those from financial institutions. If informal lending is seen as performing a useful function, especially for small farmers, in a competitive environment then the policy stance would have to change towards greater integration of the rural financial markets with more role being assigned to informal lending.

Source: State Bank of Pakistan, *Rural Financial Markets Study: Phase-1* (Karachi: 1994), 5.1–5.2.

sources in spite of the high cost shows that the demand for agricultural credit is highly service elastic, a significant factor which is overlooked'.[28] Despite increasing modernization and monetization, and growing urbanization, as well as the closer proximity of farmers to markets, one will continue to see the dominance of the informal sector in rural, as well as urban, areas. The middleman, the *arthi*, the *bisee*, or the family as a source of credit, is unlikely to be replaced for many years to come.

5.3.2 Formal Sources of Credit

Formal rural financial institutions are of different types and include government departments and corporations, co-operatives, commercial banks, and specific agriculture-related development banks (see Figure 5.5 for the changes in sources of formal credit in agriculture). Specialized financial institutions in the rural areas, such as the Zarai Taraqiati Bank Limited (ZTBL) formerly the Agricultural Development Bank of Pakistan (ADBP), may be involved in the disbursement of medium- and long-term credit. The five commercial banks in Pakistan have increasingly increased their proportion of agricultural credit and now dominate credit disbursement in the agricultural sector. However, formal sources of credit are still very limited all across Pakistan, and especially in the rural areas.

In a study conducted by International Food Policy Research Institute (IFPRI)[29] it was observed that, in the case of formal sources, the success of a scheme requires proper financial intermediation to disburse credit of the right kind at the right time, along with specialized and decentralized management structures. The study found that 'supervised credit and development of access to inputs and marketing facilities have been the major responses to tackle the problem of efficient targeting, disbursement and recovery of credit'.[30] In the case of Pakistan it has been seen that the 'development of supervised credit operations by commercial banks has been constrained by the need to limit costs of lending'.[31] In the study conducted by the Applied Economics Research Centre based on field work in the different areas of Pakistan, four major issues concerning formal rural financial institutions were found to be critical. These were as follows:

a) Targeting of Credit: A major problem with lending practices by branches is the substantial diversion of credit away from the intended beneficiaries (small farmers). In particular, a high proportion of proxy loaning exists in the case of personal sureties type of collateral. An earlier study has also highlighted this problem. Given this misallocation, there may be a stronger case for bringing rates of return on agricultural loans closer to market rates in order to remove incentives for arbitrage by large landowners and the resulting adverse consequences on equity.

b) Problems of Regulatory Policies: The presence of mandatory targets for agricultural lending and the linkage between establishment of urban and rural branches has greatly reduced the emphasis on profitability of rural banking. This has increased the orientation towards loan disbursement and permitted suboptimal location of branches. However, it appears that, in the face of high default rates, commercial banks are beginning to opt for a policy of paying penalties rather than achieve lending targets.

c) Diversification of Lending Instruments: Most banks have experimented with new types of lending instruments, including Islamic modes of financing like *musharaka*, mark-up, hire purchase, buy back finance, etc. Mark-up free loans have also been disbursed to small farmers. This has probably had a positive impact on the demand for credit as varying preferences of borrowers have been more effectively catered for. However, the mark-up system may have created a greater incentive for default, as the penalty in the event of non-repayment of a loan is linked only to the amount of outstanding principal.

d) Lack of Decentralization: High rates of default appear to have created a centralization tendency in terms of loaning powers. Increasingly, branch managers and mobile credit officers (MCO) of commercial banks are being required to refer loan applications, of even relatively small amounts, to zonal offices for approval. This is affecting the speedy and timely disbursement of loans. In addition, growing risk aversion on the part of RFIs has led to institution of more elaborate documentation requirements. This has increased borrower transaction costs and contributed to delays.[32]

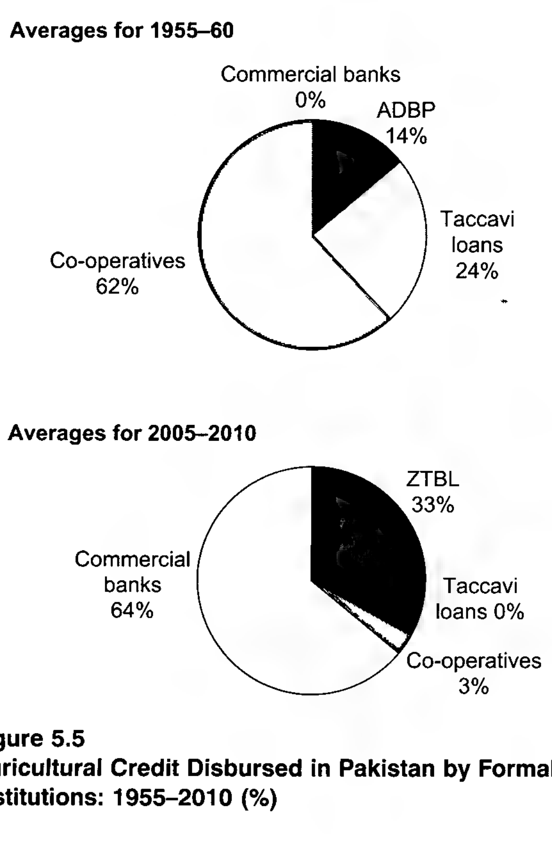


Figure 5.5
Agricultural Credit Disbursed in Pakistan by Formal Institutions: 1955–2010 (%)

The Extent of Debt

A study in the early 1960s found that 45 per cent of the cultivators in Pakistan were in debt and received an average annual cash loan of Rs. 598. The loans were utilized mostly for household expenditure (45 per cent) and livestock (36 per cent). More productive activities, such as land development and storage facilities, received a very small share.[33] The 1972 Pakistan Census of Agriculture quoted a figure of 43 per cent for the total proportion of agricultural households that were in debt. While the distribution of households in debt by size of holding showed little variation, the households with 150 acres or more were relatively more indebted: 50 per cent of households in this category were in debt compared with around 43 per cent for all other households. Of the three categories, owner households, owner-cum-tenant households and tenant households, the last named were the most indebted, while owner households were the least indebted: only 39 per cent of all owner households were in debt, while 49 per cent of tenant households were in debt. In all three categories, households above 150 acres were more indebted than smaller households.[34]

It is very interesting to observe that there was a major change by the time of the 1980 Census of Agriculture. Only 21 per cent of farm households (less than half the proportion in 1972) were in debt. Nevertheless, the pattern regarding type of household and size of landholding was similar to that for 1972. An interesting figure provided in the 1980 Census concerned the distribution of debt in terms of institutional and non-institutional (informal) sources, which stood at 32 per cent and 68 per cent, respectively. For smaller households, not surprisingly, informal sources provided much more credit than formal sources: 90 per cent of the credit for households under 5 acres came from informal sources. Compared to this, 60 per cent of the credit for households above 50 acres came from institutional sources. Owner households had 38 per cent of their credit supplied by institutional sources, while tenant households had only 8 per cent supplied from this source.[35] Clearly, access to agricultural credit from formal or informal sources was divided by type of household and by ownership patterns, with smaller households (in area) and tenant farms making greater use of informal sources, and large farms and owner-farms using formal institutional sources.

According to the 2010 Census of Agriculture, 10 per cent of all households were in debt, with 13 per cent agricultural households and 13 per cent of farm households in debt. Perhaps it is not surprising, that the smallest farm households, those who own less than one acre of land, are the least in debt (only 6 per cent of households in this segment), and a larger proportion of owners were in debt as landholdings increase. Hence, 13 per cent of households in the 2.5–5 acre segment were in debt, which rose to 21 per cent of households in the 12.5–25 acres segment, rising further to 27 per cent in both, the 50–100 and 22 per cent 100–150 acre segments. Table 5.11 shows the extent of debt by the nature of holding, as well by the time of arrangement of tenure, while Table 5.12, shows the amount of debt incurred, from both, formal sector institutions as well as informal sector intermediaries.

Bank Credit to Agriculture

ZTBL used to be the largest source of institutionalized credit in the agricultural sector, on average providing more than 64 per cent of total credit between 1995 and 2000 (Table 5.10). Commercial banks did not make any loans to agriculture prior to 1972 when they were nationalized, and at best provided loans for trade in agricultural products. In the 1995–2000 period they constituted about 20 per cent of loans in the formal sector (Table 5.10). However, all that has changed, and now the five commercial banks provide more than half of the loans from the formal financial institutions to the agricultural sector, a figure which is much smaller than what farmers, particularly small farmers, borrow from non-formal sources—see Box 5.7 for different types of loans.

Box 5.7

Different Types of Loans

The distinction between different types of loans of variable duration is important. Some salient features are as follows:

> Rural credit is usually classified as short-term (up to one year), medium-term (one to five years), and long-term (exceeding five years). Short-term loans are needed for meeting annual production costs (for example, seeds, pesticides, fertilizers), and for the replacement of a portion of the farmer's fixed capital (for example bullocks, sheds, implements, and the cost of consumption needs up to harvesting). Thus these loans can be treated as part of the working capital requirements. Medium-term loans are needed for the purchase of livestock, implements, the construction/improvement of water courses, and for equipment not expected to last more than five years.
>
> Long-term loans are needed for improvements of a more lasting character like the sinking of wells and tube wells, the purchase of additional land, or for repayment of old debts.
>
> Loans can also be categorized into productive loans and unproductive loans. According to the conventional definition, a productive loan is a loan which is utilized in such a way that it leads directly to an increase in the income of the farmer and adds to his capacity to repay. These loans may finance current production, i.e. meeting current cultivation costs and future development, i.e. increasing future returns. Unproductive loans are those which do not directly increase the efficiency of cultivation or the farmers' income. But . . . it is sometimes difficult to separate productive loans from unproductive loans.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 159–60.

Table 5.11 Number of Households under Debt by Tenure and by Type of Household: Agriculture Census of Pakistan—2010

Types of Households	All Households			Owner Households			Owner-Cum-Tenant Households			Tenant Households		
	Total	Under Debt		Total	Under Debt		Total	Under Debt		Total	Under Debt	
		Number	Per cent		Number	Per cent		Number	Per cent		Number	Per cent
1	2	3	4	5	6	7	8	9	10	11	12	13
PAKISTAN												
All Households	24,094,908	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Non-Agricultural Households	11,760,679	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Agricultural Households	12,334,229	1,565,130	13	NA	NA	NA	NA	NA	NA	NA	NA	NA
Livestock Holders	3,985,644	483,223	12	NA	NA	NA	NA	NA	NA	NA	NA	NA
Farm Households Total	8,348,585	1,081,907	13	6,811,120	829,691	12	613,027	98,536	16	924,454	153,693	17
UNDER 1.0 Acre	1,258,546	75,084	6	1,181,413	69,139	6	18,983	1,488	8	58,149	4,454	8
1.0 to under 2.5 acres	2,355,707	237,762	10	2,018,652	190,866	9	73,788	6,884	9	263,255	40,005	15
2.5 to under 5.0 acres	1,766,315	225,783	13	1,399,431	170,025	12	127,306	14,908	12	239,565	40,848	17
5.0 to under 7.5 acres	1,143,756	174,993	15	886,954	132,845	15	113,527	17,454	17	143,280	24,703	17
7.5 to under 12.5 acres	927,780	164,723	18	683,094	121,167	18	124,500	21,127		120,169	22,418	19
12.5 to under 25.0 acres	574,547	119,656	21	408,605	85,172	21	95,585	20,724	22	70,345	13,760	20
25.0 to under 50.0 acres	219,596	58,050	26	158,199	41,565	26	39,040	10,630	27	22,358	5,843	26
50.0 to under 100.0 acres	71,943	19,536	27	53,106	14,789	28	13,387	3,465	26	5,454	1,268	23
100.0 to under 150.0 acres	14,361	3,185	22	10,327	1,987	19	3,169	996	31	868	203	23
150.0 acres and above	16,076	3,154	20	11,358	2,120	19	3,724	840	23	997	193	19

Source: Government of Pakistan, *Census of Agriculture-Pakistan* (Lahore: 2010).

Table 5.12
Amount of Outstanding Debt from Institutional and Non-Institutional Source by Tenure and by Type of Household (in Hundred Thousand Rupees)

Types of Households	All Households		
	Total	Institutional	Non-Institutional
1	2	3	4
PAKISTAN			
All Households	1,701,705	857,857	843,848
Non-Agricultural Households	NA	NA	NA
Agricultural Households	1,701,705	857,857	843,848
Livestock Holders	499,752	149,294	350,458
Farm Households Total	1,201,953	708,563	493,390
UNDER 1.0 acre	78,138	24,544	53,594
1.0 to under 2.5 acres	258,129	112,229	145,900
2.5 to under 5.0 acres	249,840	142,128	107,712
5.0 to under 7.5 acres	193,699	123,810	69,889
7.5 to under 12.5 acres	185,174	123,946	61,228
12.5 to under 25.0 acres	137,297	102,559	34,738
25.0 to under 50.0 acres	68,332	53,261	15,071
50.0 to under 100.0 acres	23,477	19,656	3,821
100.0 to under 150.0 acres	3,932	3,323	609
150.0 acres and above	3,935	3,107	828

Source: Government of Pakistan, *Census of Agriculture-Pakistan* (Lahore: 2010).

5.4 MECHANIZATION

When we talk about mechanization in agriculture, it is essentially tractorization which comes to mind, and other implements are often of a secondary nature. The reason for this synonymity is the huge impact of tractorization on output, employment, the nature of social relations of production, and so on. In our analysis of the Green Revolution we saw how the HYV package was supplemented by tractorization and how these tractors had an impact on the agricultural process, changing agricultural production for ever. In this section we will discuss the effects and issues around tractorization/mechanization, and add some discussion of the use of tube wells and how this process of mechanization in the area of irrigation has affected agriculture over the years. One must add, however, that the discussion on mechanization is much outdated now, for much of Pakistani agriculture is already mechanized and debates around the consequences of mechanization no longer create controversy or take place. Much of the discussion in this section gives a view of the historical debates around and against mechanization rather than regarding current issues.

The importance of mechanization can be judged by the attitude of the various governments of Pakistan in the early years. The Report of the National Commission on Agriculture evaluates the attitude of the government in the early years as follows:

> Mechanization in Pakistan had a late start and slow initial progress because of the Government policy of restricting mechanization based on the apprehension that it would displace farm labour and cause the problem of unemployment. Even the international agencies like the FAO and the World Bank advocated caution and recommended that small farmers should not be encouraged to purchase tractors. *In retrospect, it is now clear that it was a misguided concern.* Mechanization, to the extent it has taken place, has resulted in increased farm incomes and manpower productivity and the employment effect has, on the whole, been positive. Total employment in agriculture increased from 9.8 million in 1965 to 14.6 million in 1986. The value added per farm worker also went up from Rs. 946 in 1960 to Rs. 1,357 in 1985 (constant 1959–60 prices). However, the most important development *was the generation of increased farm related off-farm employment in manufacture,* the supply and servicing of agricultural machinery, the supply of other inputs and the post harvest handling of increased agricultural production.[36]

Despite the early bias and recommendations against tractorization, there has been an astronomical increase in the number of tractors available in the country. In 1960 there were only 1,665 tractors on farms in Pakistan. In 1968 this went up to 16,583, and it had doubled again by 1975. The number of tractors increased by 400 per cent between 1975 and 1984, and in 1986, there were reported to be 187,255 tractors on farms in Pakistan.[37] In the years since then, it would be fair to speculate that the number for 1986 has increased further by large amounts. Thus, tractors have become a major ingredient in agricultural production in Pakistan. Unfortunately, even recently published government publications have rather old data. For example, Table 5.13 gives data for as long ago as 1994. However, we have recent data which shows that annual tractor production in 2001/2 of 35,038, was twice what it was throughout the 1990–98 period; in the late 1980s, the average annual production was over 22,000, which supports the claim that mechanization and tractorization has increased substantially.

An important feature of the tractorization process in Pakistan has been that most of the tractors available have been of the larger type. Table 5.14 shows that 80 per cent of tractors were in the 46–55 horsepower range, with 17 per cent in the 56–65 horsepower range. Also, the ownership of tractors (Table 5.13) is concentrated, not surprisingly, in the middle range of farm sizes. These are the dynamic capitalist farmers who played an important role in the Green Revolution. One consequence of the policies regarding tractor size and ownership, as pointed out by Mahmood Hasan Khan, was that tractor ownership 'gradually increased the size of landholdings, through both an increase in the land leased from the poor and middle peasants and cultivation by the landlords themselves at the expense of sharecroppers'.[38]

Table 5.13
Farms Reporting Use of Important Agricultural Machinery (by Size of Farms)

Farm Size (acres)	All farms	Tractors		Tube Wells/Pumps	
		Owned	Rented	Owned	Rented
All sizes	4,449 100%	285 100%	3,288 100%	479 100%	1,422 100%
Under 5.0	2,097 47%	31 11%	1,617 49%	113 24%	745 52%
5.0–12.5	1,521 34%	82 29%	1,151 35%	181 38%	485 34%
12.5–25.0	553 12%	77 27%	375 11%	101 21%	144 10%
25.0–50.0	198 4%	57 20%	112 3%	54 11%	38 3%
50.0–150.0	69 2%	31 11%	30 1%	25 5%	9 1%
150.0 and above	11 0.25%	7 2.46%	3 0.09%	5 1.04%	1 0.07%

This data is for 1994.
Source: Government of Pakistan, Agricultural Census of Pakistan, 2000–01 (Islamabad, 2003).

Just as there was a bias against tractorization in general, there have also been official recommendations in the past against providing tractors to small and medium farmers. The issue here was one of cost, since the government realized that these farmers would not be able to buy the imported tractors unless they were heavily subsidized. However, since the early 1980s, the small and medium farmers have bought tractors, many of them using loans, but more recently, a large number have probably financed their tractors from remittances from the Middle East. Since the tractors available have been of the larger variety, these small and medium farmers have had excess capacity on hand. They have made

> profitable use of the tractors by hiring out the excess capacity to do custom work for other farmers, by participating in the earth moving operations in construction of rural roads, by using the tractor to operate stationary threshers, chaff cutters, cane crushers, and other specialized equipment and, above all, by the tractor drawn trolley for haulage of goods from villages to markets and agricultural inputs and non-farm requisites from towns to villages. The use of tractor for haulage is perhaps the predominant feature of the utilization of tractors owned by the small and the medium farmers.[39]

Despite the ownership of the tractors by small and medium farm owners, as Table 5.13 shows, a much larger number of farmers in this category rent in tractors. This is also supported by the evidence that farmers have given up the more traditional bullocks at a rate higher than the rate of acquisition of tractors, implying that these farmers

Table 5.14
Number of Private Tractors by Horsepower

Administrative Units	Total Tractors	Tractors by horsepower						
		Below 26	26–35	36–45	46–55	56–65	Above 65	Not reported
Pakistan	400,446	371	448	17,385	310,524	50,971	20,149	598
Punjab	331,273	85	405	16,442	255,158	40,215	18,434	534
Sindh	36,082	4	19	255	28,325	6,428	1,047	4
KPK	23,967	282	13	388	18,780	3,980	472	52
Balochistan	9,124	–	11	300	8,261	348	196	8

Source: Government of Pakistan, *Agricultural Statistics of Pakistan 2010–11* (Islamabad, 2012). Compiled from *Pakistan Agricultural Machinery Census – 2004.*
Note: The data is for 1994.

Box 5.8

Should there be Mechanization in Agriculture?

Arguments for and against farm mechanization are raised by Viqar Ahmed and Rashid Amjad in their book *The Management of Pakistan's Economy, 1947–82*.

Against

1. Farm mechanization is basically capital-intensive. This has so far thrived in developing countries on the basis of direct subsidies and subsidized credit since scarcity of capital is not reflected in its price.
2. Mechanization of farming will divert capital and foreign exchange from non-agricultural sectors to agriculture where labour-intensive alternatives are available.
3. The argument that mechanization increases the productivity of land (except through multiple cropping) has not been conclusively proved.
4. Mechanization not only displaces labour but also induces landlords to cultivate land through hired hands, hence the social cost in terms of tenants converting into landless labourers.
5. Farm technology has a big-farmer bias and accentuates social disparity particularly in the case of assets having lumpy investments.

For

1. Mechanization encourages multiple cropping and greater intensity of cultivation and is thus land-saving.
2. It reduces the dependence upon draught animals whose number is not increasing as fast as the availability of water. One reason why the cropped area has not increased in proportion to the water supply is the inadequacy of farm power. Mechanization will free land from growing fodder for draught animals.
3. Mechanization will make dry-farming possible and will in this way counterbalance the regional bias of the package of modern inputs in favour of irrigated areas.
4. The new package of modern inputs and greater water supply can attain their highest potential yield only with the help of mechanization.
5. Mechanization lowers the cost of production by allowing more efficient utilization of land, labour, irrigation, and other inputs.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 159–60.

hire tractors from other owners. Unfortunately, the data available even in the latest *Agricultural Statistics of Pakistan* is completely outdated, and anecdotal and visual evidence suggests that the process of mechanization has gathered considerable pace and grown exponentially. Moreover, in Chapter 1, the Introduction to this book, and many of the later chapters have also argued, the process of modernization, of which mechanization is a part, has continued actively and aggressively over the last few decades, changing social and economic relations irreversibly.

Box 5.8 summarizes the main arguments which used to be made in the past for and against tractor/mechanization use. One study undertaken in 1982 in Pakistan[40] based on field surveys came up with the following findings:

1. Tractors were used mainly for land preparation.
2. Income of farmers, measured as the gross value of output per acre, *was not significantly different between tractor and non-tractor farms*.
3. The average yield levels of major crops *were not different on tractor and non-tractor farms*.
4. Cropping intensity was significantly higher on tractor farms.
5. Labour productivity was higher on tractor farms.
6. There was considerable displacement of animal labour by tractors.
7. While the use of labour falls on tractor farms, the outcome is not as severe as often suspected. However, family labour is higher on non-tractor farms and also falls as farm size increases.

Overall, it seems that tractorization does not directly result in displacement of labour on the scale suspected, and nor are yields impressively enhanced. However, Viqar Ahmed and Rashid Amjad cite a number of studies which showed that output did increase, quite dramatically. One study shows an increase of 20 per cent, another shows that maize and wheat increased by 30 per cent, and they quote yet another study by the World Bank (although conducted in 1969) that there is an increase of between 140 and 200 per cent in cropping intensity on irrigated farms due to mechanization in the Punjab.[41] Nevertheless, the *nature* of labour changes as a result of tractorization. If farm labour, and especially tenants, are displaced, they are often replaced by the short-term wage workers, which sometimes causes a problem of shortages at peak times. Tractorization also implies the resumption of previously unused land, or land let out to subsistence farmers, often displacing them. But the issue of tractorization, and especially mechanization, cannot be looked at in isolation. Numerous externalities need to be considered.

Once tractorization and mechanization commence, they give rise to numerous ancillary activities. A process of small-town urbanization begins, and technicians and skilled workers related to mechanization are created. Off-farm activities increase, and other avenues away from agriculture are opened up for employment purposes. Traditional methods, values and traditions are confronted by inventions of the new age, and the slumber of old habits and times is broken. In essence, mechanization is a dynamic process that affects institutions and economic and social relations, and transforms entire regions. These impacts must not be underestimated

for they can overwhelm societies. Many of these changes are irreversible: some presumed to be detrimental, others considered to be progressive. Nevertheless, the question is not *whether* technology in agriculture and elsewhere ought to be used, but *how*, and to whose benefit.

5.5 Agricultural Income Tax

The debate over whether agriculture should be taxed is an important one, and many reasons are given for and against imposing taxes on agriculture (see Box 5.9 and Appendix 5.5). As much as taxation is an economic issue, where the government is concerned about increasing its revenue and dealing with the budget deficit (see Chapters 10, 11, 16 and 17), it is also a political issue, where some political lobbies have resisted, while others have demanded such a tax. The politics of taxation of the agricultural issue is reflected not only in parliament and government, but also in reports and commissions set up to study the issues. The 1988 report of the National Commission on Agriculture (NCA) is one such example.

The report of the NCA is one of the better and more comprehensive documents produced by the Government of Pakistan. Indeed, the present chapter has drawn a great many of its arguments from this source. However, the true colours of the Commission come through when it discusses the issue of agricultural taxation. The following, somewhat lengthy, excerpt from the report shows how the Commission floundered on an extremely important issue.

> A section of the business and industrial community has been pressing that there are excessive agricultural incomes that must be taxed [sic]. Their contention regarding the sector as a whole is unfounded as most of the agricultural holdings are too small to generate taxable surpluses of income. Even for the relatively large holdings there is no assurance of sustained incomes. Agriculture by nature is a risky business and incomes can fluctuate from negative returns in some years to very good incomes in others. Extreme dependence on natural factors creates a high degree of uncertainty for the final output which is not even insurable with insurance firms. A farmer can, for instance, lose all or most of his harvest due to some natural catastrophe and he may lose not only that year's income but also some of his capital like the livestock. The farmer acts as his own insurer in the absence of the commercial insurance facilities. In good years he pays his accumulated debts and then, if possible, generates some savings to supplement his capital stock to make up for losses in bad years. The replenishment and the building up of farm capital is an essential condition for sustained growth in agricultural production. Unlike industrial establishments with easy access to multiple sources of credit, the farmer has to finance capital replacement and additions largely from his own savings. If these savings are skimmed off, the farms gradually lose their capacity to produce and the whole country suffers.
>
> . . . Although the incidence of direct taxes on agriculture is small relative to other sectors, the total proportion of income transfers out of agriculture is quite high. *There is no scope for further taxation of the sector without adverse impact on the sector's productive capacity. In the face of this situation the demand that agricultural incomes should be taxed as personal incomes in line with other income earners in the country must be rejected as counter productive.* However there are certain inadequacies and inequities in the present system which must be removed.[42]

In an earlier official report, the National Taxation Reforms Commission (NTRC) in 1986 evaluated the possibilities of imposing a tax on agriculture. Although there were some disagreements about how, and if, further taxes should be imposed, the members of the Commission on their analysis of the existing situation argued as follows:

> Although a vast majority of people engaged in agriculture are living below subsistence level, yet a number of persons in this sector are enjoying better incomes. This has been mainly due to two reasons. A number of bigger landowners managed to save their lands from the two land reforms by various devices and secondly, many agriculturists have set up orchards, fruit gardens, vegetable and horticultural estates, etc. on their lands which yield higher incomes. The Green Revolution and mechanized farming have also increased the income of a large number of agriculturists. There is now a class of landowners who reside in urban centres and have made substantial investments in real estate in the cities. Since they pay no income tax at all, they have created jealousies among the trading and industrial classes as well as the professional and the salaried class who have to pay income tax. This is why demands for levy of income tax on agricultural income keep constantly pouring from various trade associations and chambers of commerce and industry. Persons in the professions have also voiced their protests in the press against exemption to agricultural income. It has been stated that the existence of an exempted class among the taxpayers discourages tax compliance and provides strong incentive for tax evasion amongst businessmen and professional income tax payers.
>
> Many traders and industrialists have purchased agricultural lands with the intent to whiten untaxed black income from business by showing it as agricultural income. Also many businessmen have entered into collusive arrangements with land owners; they obtain fictitious leases of lands from which they show enormous amounts of agricultural income which, in fact, is their business income and thus escape income tax.[43]

Box 5.9

The Issue of Agricultural Taxation

Should agriculture be taxed? There are a number of arguments presented for and against a tax on agriculture, and Viqar Ahmed and Rashid Amjad summarize some of the main issues.

Arguments against income tax on agriculture

1. It would be inconvenient to both the tax-collectors and taxpayers since farming in Pakistan is generally of the subsistence type and not of the commercial type. Farmers do not maintain standardized accounts of their costs and returns and, therefore, it is difficult to assess their net incomes.
2. The number of farmers is very large and they are scattered all over the country, many in remote inaccessible areas. It would cause considerable loss of time and money to even contact the potential taxpayers.
3. Agricultural incomes being uncertain, depending upon the vagaries of nature, it is quite probable that a large number of farmers may frequently move across the tax exemption limit, thus making it difficult and laborious for tax authorities to keep tabs on them.

Arguments in favour of income tax on agriculture

1. It is unfair and illogical to make a distinction between agricultural and non-agricultural incomes for purposes of taxation. Just as incomes below a certain level are exempted from tax in case of non-agricultural incomes, the same principle should be extended to agricultural income. This would take care of the large majority of subsistence farmers who would be automatically excluded.
2. There is considerable evasion of income tax by those having both agricultural and non-agricultural incomes. Part of their non-agricultural income is shown by them as accruing from agriculture, thus evading the tax. Extending income tax to agriculture would reduce tax evasion.
3. Agricultural income tax would be more income-elastic than land revenue. With a greater yield per acre, higher procurement prices and mechanization, the benefits of which are mainly confined to large farmers, incomes in the agricultural sector have risen considerably but yield, in terms of direct taxes from agriculture, has not risen so fast. Between 1972–3 and 1978–9, the yield from direct taxation on agriculture (land revenue and irrigation charges) increased by 78 per cent (from Rs. 472 million to Rs. 762 million) while value-added in agriculture at current factor cost increased by 157 per cent (Rs. 21,907 million to Rs. 56,370 million).

Is agriculture already over-taxed?

1. Agriculture is subject to a large number of direct, indirect, and hidden taxes. Indirect taxes constitute over 85 per cent of the total revenues of the federal government. Since these taxes are paid by all, it can be safely assumed that the agricultural population (being about three-fourths of the total population) bears a heavy burden. There are also hidden taxes in the form of low procurement prices paid by the government for many agricultural products, export duties on agricultural commodities, and the mechanism of terms of trade between industry and agriculture.
2. Increase in agricultural incomes has been offset by a rise in population and higher expenditure on agricultural inputs and equipment.
3. Higher taxation on agriculture will adversely affect the motivation for savings and investments at a time when farmers must make larger investments in order to increase productivity.
4. Agricultural income has increased not only due to higher income per acre but also due to the increase in area under cultivation. Higher taxation will discourage farmers from bringing new land under the plough.

Further capacity for agricultural taxation

1. Direct taxes on agriculture have risen at a slower pace than growth in agricultural incomes.

   But the introduction of subsidies to agricultural producers on inputs and to urban consumers on wheat, edible oil, and sugar provides further complications. Subsidy is a 'negative tax' and should be taken into account while calculating relative tax burdens. Gotsch and Brown have attempted the calculation of subsidy transfers between the agricultural producers, the urban consumers, and the government (which includes both the federal and provincial governments).

   The data supports the view that the rural sector has (a) received much less subsidy from the government than the urban sector, and (b) contributed a substantial share to the consumer subsidies. However, these figures do not show the full effect of the subsidy transfer due to, apart from other reasons, the fact that Gotsch and Brown did not include in their calculations such implicit subsidies to agriculture as canal water, power supply, institutional credit, and the benefits of extension services.
2. Any comparison of an aggregate tax burden on agriculture with another sector will have little meaning in terms of equity unless a large number of variables are considered and given due weightage. However, a simple comparison between direct taxes on agricultural and non-agricultural incomes will be instructive.
3. The population argument is weak because the urban population has increased even faster than the rural population due to both natural factors and migration from the rural sector.
4. The major benefits of a rise in incomes due to higher yield in agriculture went to larger farmers. This has intensified inequities in income distribution in the rural sector and would indicate additional taxable capacity.
5. The rise in incomes has not been accompanied by any corresponding increase in the level of domestic savings which has remained low. The failure of the government to expropriate this surplus has resulted in a considerable increase in consumption expenditure of the rich farmers. According to Alavi, even when there are adverse changes in terms of trade (for agriculture) the rural élite enjoy considerably enhanced real incomes.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy 1947–82* (Karachi: Oxford University Press, 1984), 156–7.

One argument that has been raised against imposing any further taxes on agriculture is that the agricultural sector bears the heaviest burden of indirect taxes, which according to the NTRC were 42 per cent of all indirect taxes at a time when contribution by agriculture to GDP was only 26 per cent.[44] The NTRC report also cited figures which showed that as much as 20 per cent of the net income of the agricultural sector would be transferred out in 1986/7 through taxes, subsidies, and price transfers—equivalent to Rs. 30 billion, which in that year was more than three times the total collection of income tax.[45]

Anjum Nasim and Asya Akhlaque examined the need for an agricultural tax and say that it is justified on 'grounds of horizontal equity (individuals in equal economic position should be taxed equally)', and also due to the practical compulsions that ensue.[46] Exempting agricultural income usually has a disincentive effect on those who pay tax, and raises the 'possibility of evasion and fraud by attributing incomes from non-agricultural sources as agricultural incomes or by passing-off unexplained loans as loans from agriculturalists'.[47]

Those who support the proposal of imposing agricultural income tax show that while the amount of indirect taxes paid by the agricultural sector in 1986 was higher than other sectors, the bulk of this taxation was borne by the low-income groups and poorer farmers.[48] This view supports the claim that indirect taxes are highly regressive and inequitable. An argument that the anti-taxation lobby continues to propound is that the agricultural sector is in bad economic shape as a whole, and thus should not have taxes imposed on it. The pro-tax lobby argues that despite this poor shape, a number of individuals do earn very large incomes and there are no grounds for allowing them to go scot-free. Taxes are imposed on personal income and not on the sector as a whole. Moreover, other sectors of the economy are often also 'in bad economic shape', but must be accountable to the exchequer for any profit, or even production, that they undertake. Hence the argument that agricultural income should be exempt from taxes does not hold on equity grounds, and given the financial and budgetary shortfall and constraints faced by the government, the need to tax agriculture gains greater urgency; *the principle of a tax on income should be applied irrespective of the source of income* (see Appendix 5.5 and Chapters 10 and 11). Moreover, as Box 5.10 shows, the loss to the economy on account of the absence of a proper agricultural income tax is quite substantial. Also see Chapter 10 on Taxation, for further discussion on the agricultural income tax.

5.6 The Water Crisis[49]

Of the total cropped area in Pakistan, which includes area sown more than once, of 22.15 million hectares, 18.04 million hectares or 81 per cent is dependent on irrigation primarily through canals and tube wells, showing the importance of a good irrigation system to Pakistan's economy and agricultural sector. As we show in Chapters 3 and 4, the development of water resources was a major focus of public investment in the 1960s, along with the increase in private tube wells. The increased availability of water was a key factor which led to the Green Revolution. However, the irrigation system and network in Pakistan has deteriorated in recent decades and a water 'crisis' has emerged.

Due to poor maintenance, the canal irrigation system has had its capacity of carrying water reduced, primarily because the desilting of canals has not taken place regularly and also due to the crumbling of canal banks. A 1994 World Bank study revealed that delivery efficiency—from the canal head to the root zone of crops—was around 35–40 per cent, implying that a substantial majority of water is being lost due to canal seepage, spillage, breaches, and watercourse losses. While this means that farmers do not get adequate water for their crops, particularly those farmers who are towards the tail-end of the watercourse, the loss of water also gives rise to waterlogging and salinity, of particular concern in the province of Sindh which is losing its fertile land due to this problem.

Five major issues are identified in what constitutes Pakistan's water crisis: (i) Pakistan does not have adequate reservoir capacity in its irrigation system to store water at peak flows where the country's rivers are highly seasonal with 85 per cent of annual flows in summer. (ii) As we show above, only about 40 per cent of water from the canal head reaches the root zone, causing waterlogging and salinity, with a large proportion being wasted. (iii) Although a very large infrastructure of irrigation exists in the country, it does not have a drainage system commensurate with the size of the network. This leads to rising water tables and further salinity and waterlogging. Without drainage facilities which can remove excess water and salt from the soil, further land will continue to be lost to this process. (iv) Inequality of power based on private property and privilege is a serious problem in Pakistan, particularly in the agricultural sector. Large landowners try to dominate the rural sector and are amongst the main culprits who steal water and misappropriate a share which is larger than what they are entitled to. They use pumps to get water from canals and are known to bribe local irrigation department officials to get an inequitable share of water. Also, since water availability is limited, often those at the tail-end of the irrigation system fail to get their share. (v) There has been insufficient maintenance of Pakistan's irrigation network and this has compounded the water crisis, causing losses, not just in terms of water, but also land and financial resources as well.

These numerous factors have all resulted in a scarcity of water, its misuse, and their impact on output, yield, and production. Waterlogging and salinity, which is said to affect 28 per cent of Pakistan's irrigated lands—50 per cent of Sindh's land—not only causes land to be lost to cultivation, but its spread towards otherwise uncontaminated land, also threatens such pastures. Add to this the growing pollution of rivers and water sources, caused as a consequence of urbanization, development, and the indiscriminate discharge of sewage and municipal waste and effluents, all of which has killed not only marine life in the rivers, but has also made this water hazardous for human consumption and for agriculture.

The drainage problem referred to above is considered to be a consequence of extending the modern irrigation system and assuming that nature would dispose of the additional water, as little thought was given to how this water was to be drained. The built system provided more water than the land was able to drain causing waterlogging and salinity on a large scale. In addition, this excess water—ironical though this is at a time when a lack of water has been an issue—has caused the water table to rise in places, leading to the degradation of land and the destruction of lakes. Although one can put forward the argument that better planning should have been undertaken when the irrigation system was conceived and planned, the capacity of the infrastructure has been overtaken by 'development', economic growth, and urbanization. The core systemic problem that one sees here with regard to the water issue, irrigation, and the lack of drainage is not unique to the agricultural sector, and is one which is found in almost every public sector initiative in Pakistan (also see Box 5.11).

5.7 Land Ownership, Power, and Land Reforms

Although we have argued in an earlier chapter that the social and economic structure of agricultural relations in Pakistan is not feudal, we have also said that there is a need for land reforms. It is important to emphasize the point that the desire and need for land and broader agrarian reforms, is dependent on the size of landholdings and their

Box 5.10
Revenue Potential from an Agricultural Income Tax

Masood H. Kizilbash writes about the potential economic and revenue impact of an agricultural income tax.

Income from agricultural activity has remained outside the federal income tax regime since the creation of Pakistan in spite of the formation of several committees, task forces, and commissions in the past for the examination of the issue. A ray of hope was rekindled recently when some of our parliamentarians vociferously pleaded for inclusion of the agricultural income in the budgetary proposals for 2010–11 at the federal level. As usual, the demand was spurned on questionable reasoning of the proposal as unconstitutional. If the argument holds ground, one wonders why it was not made a part of the Eighteenth Amendment unanimously passed recently containing more than 100 amendments in the constitution.

One had hoped that in view of large fiscal deficit aggregating Rs. 680 billion and a pressing need for resources, the provinces might feel obligated for patriotic reasons to at least raise the rates of presumptive land tax to a level that a portion of growth in income from liberal upward revision in support prices of principal crops such as rice, wheat, cotton, and sugar cane could be siphoned off for raising revenues. With the announcement of the provincial budgets this hope has also been dashed.

Agricultural income tax was introduced for the first time in 1996–97 by provinces as a part of a 'Reform Package'. The package was to be implemented in three phases. In the first phase beginning 1996–97, the provincial governments were to impose agricultural income tax on presumptive basis per acre of farm holdings with variations in rates between barani and irrigated land and exemption limits of 25 and 12.5 acres respectively.

During this phase a periodic downward revision of the exemption limits coupled with an upward revision in the presumptive tax rates was to be made so as to achieve a target of 0.5 per cent of GDP. In the second phase starting from July 1, 1998, agriculture income tax was to be assessed on the basis of 'rental value of land' for which valuation table in each district was to be prepared. This phase was to last two years.

In the third and final stage, income tax was to be based on assessment of 'total income' including income potential of land and income from other rural activities such as poultry, fish farming, forestry, and livestock. In this phase a tax schedule similar to one used for non-agricultural incomes was to be developed for assessing tax on agricultural income.

It was estimated in May 1996 that in the first year on the basis of 'presumptive land tax' the revenue will increase to Rs. 2 billion in 1996–97 and to Rs. 4.4 billion in 1997–98 as against land revenue yield of Rs. 1.3 billion in 1995–96. In the second phase, with the 'rental value of land' as a basis of assessment of tax, the revenues from AIT were to touch the level of Rs. 7.4 billion in 1998–99. In the final phase starting 2000–01, when assessment was to be based on income from land, land potential, and rural activities, total tax revenues were projected between Rs. 40–50 billion or more than two per cent of GDP.

The implementation of the reform package over a period of 5–6 years remained a nightmare. For, as outlined in the package, what to speak of determining 'annual rental value' of land in each district and calculation of presumptive income tax based on 'gross value of production minus cost of production', the provinces neither reduced exemption limits nor raised the rates of tax on landholdings despite manifold growth in income.

The result is that the combined provincial revenues from the so called agricultural income tax will be around Rs. 2 billion in 2010–11. At this level it will be just three per cent of the total provincial tax revenues and just 0.015 per cent of the GDP as compared with benchmark land revenue of Rs. 1.3 billion or 11 per cent of total tax revenue and 0.06 per cent of GDP in 1995–96. It explains that instead of AIT proceeds going up over last 14 years of the reform package, they have continuously declined.

Dawn, *Economic and Business Review*, Karachi, 28 June–4 July 2010

numerous consequences, and not simply on the nature of land ownership. Thus, while we would insist on the need for extensive land and agrarian reforms if there was feudalism in agriculture, we would continue to make the same, or at least similar, arguments in favour of wide ranging reforms in the agricultural sector, regardless of the mode of production, even when there was capitalist agriculture, as is the case now. The fact that there is a very large landowning class which, not surprisingly, is against any form of land reforms, only re-emphasizes the need to raise arguments which look at this issue.

This rural élite, which we argue is not feudal, has nevertheless, a disproportionately large influence on the 'social, political, and administrative structure of Pakistan. The effects are visible in different and disturbing forms throughout the society. The process of agricultural transformation has been greatly distorted by the influence of the landed élite and the wrong policies of successive governments. . . .'[50] The issue of land reforms is intrinsically linked with the issue of power and control of the ruling élite and the consequences of this power and control. This point is of even greater importance—as we show in Chapter 22—where poverty has emerged as one of Pakistan's biggest problems where one-third of the country's population—nearly 60 million inhabitants—live in poverty, most of them in rural areas. Whether it is access to the state bureaucracy—provincial or local—or to fertilizer, credit, and output markets, large landowners have far greater access than do small farmers. As Mahmood Hasan Khan states, there is 'no dispute that land is the primary factor determining the access to other factors in agriculture.'[51]

If we take the case of state credit availability and disbursement for example, we see that around 75 per cent of loans from the Zarai Taraqiati Bank Limited (ZTBL) have been towards farmers with holdings of more than 5 hectares, and much of this money has been used to purchase tractors and machines and to install tube wells. 'A substantial subsidy implied in public loans for agricultural production has been transferred to a small number of large landowners, farmers, and entrepreneurs, mainly on the basis of their political influence or contact'.[52]

Mahmood Hasan Khan argues that there is a 'bias in favour of large landowners and well-connected farmers which is built into the credit system because of risk minimization through the collateral requirement, low administrative cost and convenience, and the influence of landlords and similar urban-based groups. . . . Sharecroppers have no direct access to institutional credit'.[53] Given the high transaction costs and collateral requirements and numerous other constraints, the official disbursement of credit has been noticeably tilted in favour of large farmers, and the landless, the sharecroppers and even small farmers, have had to borrow from non-official sources, often at exorbitant usurious rates.

Much research that takes place in Pakistan and elsewhere, relies on data and statistics provided by the government on the basis of which policy is made. Sometimes surveys are held which help enlighten public policy. In a study conducted in 2003, a very extensive survey was conducted in Pakistan, in all the four provinces, and in the Northern Areas where the focus was on the very poor. The Pakistan Participatory Poverty Assessment asked thousands of individuals living in abject poverty about why they thought they were poor, about the nature of their poverty and about what they feel is necessary to get them out of that poverty. The results from this survey confirm what many people feel intuitively.[54]

The poor felt that the single largest reason for their poverty was lack of access to land, whether to own land (which most of them don't) or to work on land. The concentration of landholdings was a cause for the impoverishment of the poor because they have limited assets to work with, but more importantly, because this opens up vast possibilities for their

Box 5.11

The Water Crisis

An expanded water supply from the canal system has been a major source of change in the use of land. However, the availability of water has been constrained by several factors, some at the regional and others at the village level. Water acts as a major constraint because its management at the canal and farm levels is very poor, caused by inadequate physical infrastructure and the low level of water charges. Its distribution generally discriminates against the tail-enders and small farmers because of the unequal power of the small and large landowners in the village. In view of the chronic shortage of canal water in the country, the regions at the tail-end of the system are handicapped in adopting new crop varieties and adjusting the cropping patterns. Farmers in Sindh, in particular, are adversely affected since they are at the tail-end of the canal system and they cannot make use of the groundwater. Added to these problems is the persistent shortfall in the government's irrigation revenue to cover the maintenance and operation costs of the canal system. As part of the structural adjustment support given by the International Monetary Fund (IMF) and the World Bank since the mid-1980s, the canal irrigation system is expected to be transferred from the provincial irrigation departments to the so called autonomous (private) irrigation authorities. While this programme is consistent with the adjustment policies of the two international agencies, it has generated much genuine debate and controvery in the country with regard to its likely benefits and costs in the current social and operational environment.

Source: Khan, Mahmood Hasan, 'Agricultural Development and Changes in the Land Tenure and Land Revenue Systems in Pakistan', in Khan, Shahrukh Rafi, *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999), 110.

ultra-exploitation and abuse. The power which derives from inequitable landholdings is a cause and reinforcement for keeping people in poverty. Moreover, land is seen to be an important source of power and well-being across all the rural sites where the survey was held—see Chapter 22 on poverty in Pakistan for further discussion.

There are numerous arguments which lead us to believe that there is a need for an extensive land reforms programme marked by a supporting agrarian reforms initiative—see Box 5.12. While restricting the size of holdings of landowners may eventually break their power on local administration and on the poor, distributing land to the landless will bring many of the 60 million poor out of poverty. Not only will their economic welfare improve, but so will their social position once they have access to and own land. Economic evidence also suggests that there is an inverse relationship between size and productivity: above a certain minimum threshold, smaller farms are more efficient and productive compared to larger farms. The fact that the earlier land reforms—see Chapter 3—have not been a resounding success because there were problems in design and they were not properly implemented and because they were not supported by a package of broader agrarian reforms, only means that this time round there is a need to build on those experiences and learn from previous mistakes. A comprehensive land reform programme backed up with easier terms and access to water, credit, marketing, extension, and advice could address Pakistan's poverty question as well as remove the constraints that have emerged in the agricultural sector. Sadly however, the General Musharraf government which took over power in 1999 or the elected government following him in 2008, have repeatedly said, that they do not favour land reforms. This means that the inequitable hold over land and power will continue in Pakistan's rural sector, and also that poverty is unlikely to be reduced significantly.

Just as an agricultural income tax is a must on income earned from agriculture, simultaneously, reforms in the agricultural sector, which favour the poor, the landless, and the small farmer are also essential. It has become unfashionable in the Pakistani context to talk about land reforms, but the arguments are still valid. Whether it is the distribution of state land to landless peasants or the more radical demand for the imposition of lower ceilings on land holdings and redistributing land above that limit to landless farmers, such demands need to be part of the public discourse to warn against the sort of violence and injustice which takes place on account of extremely inequitable landholdings in the presence of an effective state machinery which is in the control of the landlord. Unequal land ownership in the context of Pakistan also leads to forceful and disproportionate acquisition of other public goods such as water. The highly exploitative treatment of peasants, particularly women in rural areas, is one of the consequences of the absence of justice and the presence of power derived from owning land. Many of the problems which exist in rural Pakistan emanate from the pattern of landholding. The demands for land and agrarian reforms are just as pertinent today as they were three or four decades ago. Rather than planning to sell or lease Pakistani agricultural land to the Arabs which the Pakistan People's Party government of Yousuf Raza Gillani and Asif Zardari came up with—see Box 5.13, it might be more appropriate to think of mechanisms related to land and agrarian reform in Pakistan which help Pakistan's landless and poor peasants directly. The option of land reforms ought to be always high on the agenda and an option worth stating.

Haris Gazdar highlights the important distinction between *land* reforms and *agrarian* reforms in Pakistan, reminding us of the critical distinction between both, making the case that one needs to 'broaden the view' about such reforms. He argues:

> The conventional debate about land reform has been linked very closely with analysis of agrarian structures. The main—perhaps the exclusive—focus was on land as an agricultural asset. Land reforms were regarded as the means for effecting distributive and technological change within an agricultural economy. Land reform, in fact, was often thought to be synonymous with agrarian reform, with primary interest being directed to crop farming. Perhaps the declining salience of land reforms from the policy and political agendas is to do with economic diversification. If crop farming is but a small part of the national economy, employment in crop farming (for landowners and the landless alike), represents just one out of many sources of livelihood. It is not surprising that the scramble for public sector jobs competes with mobilization for land reform as a consumer of political energies. . . .
>
> . . . The returns on land ownership, moreover, are not simply of a straightforward economic nature. Control over land and its use is leveraged into advantage in broader spheres in the economy and politics. Despite the declining salience of crop farming and agrarian reform from the policy and political agendas, the ownership and possession of land remains an arena of intense contest. . . .
>
> . . . Broadening the view means paying attention not only to crop-farming but to issues in the ownership, access and use of land for a range of economic purposes. Even within a traditional agrarian economy usufruct rights to uncultivated land were of immense economic value to local residents.[55]

Some economists have shown empirically that land reforms in rural areas may not lead to economic growth, and hence have argued that such reforms are not worth pursuing. Their empirical evidence may indeed show why this would happen, for a number of reasons, although there is also a large body of evidence which contradicts such findings and shows the exact opposite. Such is the state of economics. However, if economists simply see land reforms as a growth-enhancing intervention, they miss much of the social and political consequences of holding on to large tracts of land in societies where there are far more small and landless farmers. Inequality, especially on account of land holdings—as opposed to say, opportunity—does give rise to social

Box 5.12

The Benefits of Land Reforms

Aadil Mansoor makes the case for land reforms in Pakistan.

That land reforms lead to efficient utilization of land, improved agricultural production, employment, and poverty reduction is a well-established argument, supported by theory and empirical evidence. China and several countries of East Asia have successfully used land reforms to reinvigorate agricultural growth, promote employment, and reduce economic and social inequalities. In the case of Pakistan, a growing and vibrant agriculture sector in the 1960s marred the need for the much needed land reforms. While two formal attempts at land reform were made in 1959 and 1972, both failed to achieve their stated objectives as they were mainly meant to contain social unrest and political chaos and to gain popular support in times of crises.

A closer look at the cultivable land ownership and use statistics of Pakistan make the need for land reforms obvious. First and foremost, research shows that in much of the developing world, where agriculture is characterized by constraints to investment and mechanisation, small and medium-sized farms (12 acres) are more efficient than large-sized farms (20 acres). Several empirical studies demonstrate that, if the effect of capital, technology, and other factors is held constant, the income per acre of land from small farms can be up to double that of large farms. This becomes possible because of a higher allocative efficiency of land in the case of medium and small-sized farms and the lower reservation price of labour for small farms in contrast with the larger farms that have to hire labour thus making it expensive for them.

Secondly, the Pakistan Agricultural Census shows that nearly 40 per cent of the arable land (i.e. 4 million hectares) is not cultivated in a given year. Almost 2/3 of this utilization land is held by large landowners, who own 25 or more acres of land, pointing towards the unmanageability or inefficiencies that are associated with large and concentrated landholdings. In contrast, most small farms cultivate over 90 per cent of the arable land, deriving maximum benefit per acre of land.

The third important issue pertains to the weak land tenancy in the country, where nearly one-third of the cultivable area is under tenancy. Amidst an absence of tenancy regulation and social safety nets, tenants are more often than not wholly dependent on and indebted to the landlords. Often tenancies are carried from one generation to the other and so are the debts and obligations, at times taking the form of bonded labour. Tenancy contracts are mostly informal and hence not enforced legally. Research has shown that incomplete tenancy contracts lead to 'investment holdups', where due to tenure insecurity the tenants tend to under-invest in productivity, thus leading to inefficient and suboptimal factor productivity of land.

Fourthly, in Pakistan's 'labour surplus' economy, almost 44 per cent of the labour force is employed by the agriculture sector. Due to the highly concentrated distribution of land, a large part of the labour force is landless and is hired seasonally, while others work as sharecroppers or tenant families under a wide range of contract and tenancy regimes. However, as discussed above, the efficiency losses from incomplete contracts and insecure tenancies can be overcome by means of land redistribution and private ownership, where land can be distributed to a part of this labour force thereby creating incentives to invest in productivity enhancement and conservation.

And finally, land being the most valuable asset and a symbol of social status also serves as a source of monopolization of political and social power. In Pakistan, unequal landholdings have led to social polarization and exploitation of the landless and small holders by the landed élite. In the rural arena, feudal capture of political institutions, public service delivery and extension services, access to farm credit, sources of inputs, and means of marketing is hard to ignore. This has not only affected agricultural productivity but also suppressed the social, political, and economic progress in the country.

One may ask that, given a total failure of previous land reform efforts, is land reform a mere idea in Pakistan's context? Experts have extensively reviewed the land reforms of 1959 and 1972 and have suggested that the failure of earlier land reforms was not a 'strategy failure'—i.e. land reforms as a strategy for improving factor allocative efficiency and agricultural productivity and reducing unemployment, economic inequalities, and poverty. Various studies have suggested that reforms failed due to a) lack of political commitment, b) loopholes in legislation, e.g. provisions for exemptions and allowance of land transfer to heirs, c) the burdensome payments that the beneficiaries had to pay for the allotted land, and d) centralized and inefficient bureaucratic administration.

Recent land reform experiences of China, East Asian economies, and selected regions of South Asia provide substantive evidence that land reforms are not only possible but also lead to positive economic and social outcomes. Depending upon the political, social, and economic context, base conditions, and specific objectives, different countries have applied different policy instruments, strategies, and management models to land reform. The choices, trade-offs, and balancing acts have involved setting the ceilings for landownership, government engagement versus the use of market based approaches (e.g. incentives, penalties, and taxes), allocation and pricing of expropriated land, and time frame for implementation. Pakistan can draw upon a wealth of international experience and learning to develop its land reform strategy.

Source: http://pakteahouse.net/2010/04/09/food-for-future-pakistan-has-moved-from-being-an-exporter-to-an-importer-of-food/, accessed on 25 June 2012.

Box 5.13

Selling Pakistan to the Arabs?

Myra MacDonald commented on the Pakistan People's Party government's decision to sell Pakistani agricultural land to the Arabs.

Any student of history will tell you that a recurring feature of 20th century revolutions and civil wars was conflict over land ownership, driven by the resentment of the rural poor against the concentration of agricultural wealth in the hands of the élite. (Cuba and Vietnam, where Fidel Castro and Ho Chi Minh picked up support by championing farm reform, are good places to start.)

So Pakistan's plans to sell farmland to rich Gulf investors deserve serious attention, even if land ownership does not have the same ability to grab headlines as its nuclear weapons. Waqar Ahmed Khan, the Federal Minister of Investment, said last month Pakistan was offering one million acres of farmland for lease or sale to countries seeking to develop food supplies, and was holding talks with Saudi Arabia, the United Arab Emirates, Bahrain, and other Arab states. He said all land up for sale or lease was currently unused and promised to hire a security force of 100,000 men, funded by foreign aid, to protect their investments.

His comments prompted a column in U.S. website The National Interest, which argued that the farmland sales would serve as a recruitment tool for Islamist militants who have already picked up support by championing the cause of Pakistan's rural poor against the feudal élite which dominates the country. The devil, as usual, will be in the details, but the following obvious questions spring to mind. What does it mean for Pakistan's fractured society?

http://blogs.reuters.com/pakistan/files/2009/05/wheat.jpg

In an article in the Huffington Post, Eric Margolis became the latest to argue that the battle against Islamist militants in Pakistan's north-west is in danger of morphing into a much wider conflict—'a national revolution in Pakistan against the western-backed feudal oligarchy that has ruled it since 1947.' If correct, then any perception that the rich were benefitting from farmland sales at the expense of the poor would only stoke this anger further.

An editorial in the Daily Times says that 'despite the blatant forms of exploitation that keep occurring due to skewed landholding patterns in our rural areas, it was disappointing that major political parties did not squarely take up the issue of land reforms in their manifestoes prior to the 2008 general elections. Conversely, instead of trying to take concrete steps to empower the rural poor, the current government is now trying to lease or sell large tracts of agricultural land to Arab states, in lieu of attracting foreign investment to Pakistan.' http://blogs.reuters.com/pakistan/files/2009/05/indus.jpg

'Government officials claim that the land being offered to the Arab nations is not under cultivation, therefore there is no threat of displacement of indigenous communities, or erosion of local food sovereignty. However, the environmental hazards posed due to deforestation, land degradation, and increased water consumption also need to be taken into account before making such confident claims,' the editorial said.

Dawn newspaper reported that the provincial government in Balochistan was putting the brakes on plans to sell farmland to Arab investors. However, the unnamed experts it quoted appeared to be divided between arguing that farmland sales would bring much needed investment and modern management techniques to Pakistani agriculture and questioning the details of how the scheme would be implemented—rather than opposing the idea outright. So what kind of farming would outside investors bring to Pakistan?

Modern, intensive farming methods are high on productivity and low on labour—suggesting there would be few employment opportunities for the rural poor other than to guard the food that is to be shipped out of the country—unless the scheme includes parallel investment in infrastructure and agriculture-related business like food processing.

Environmentalists also complain that intensive farming usually relies heavily on the use of fertilizers and pesticides, polluting the surrounding environment, and by clearing large tracts of land can contribute to soil erosion and, in some places, desertification. So depending on how the scheme is implemented, Pakistani farmers could suffer, rather than gain, from the expected influx of modern farming methods.

And what about the demand on water?

Since the government says it plans to sell or lease farmland which is not currently being used, the demand on water is likely to increase. Yet Pakistan already faces water shortages, partly due to its rising population. Global warming, which is slowly melting the Himalayan glaciers which feed the country's rivers, is likely to make water supplies more erratic, increasing flooding and reducing further the availability of groundwater for farming. And as discussed elsewhere, water scarcity is likely to increase tensions with India about the use of water from rivers they share in divided Kashmir.

It's too early yet to judge how the scheme would work. And in an article in Britain's Independent newspaper, David Hallam, the deputy director of the trade and markets division at the Food and Agriculture Organization, was quoted as cautioning against making over-hasty judgments about global farmland sales as a whole. 'This could be a win-win situation or it could be a sort of neo-colonialism with disastrous consequences for some of the countries involved,' he said. 'I really do have an open mind to whether this new development is positive or not.'

What is clear, however, is that in a country like Pakistan that has been turned into a tinderbox, every spark is potentially explosive.

Myra MacDonald, 'Pakistan's farmland sales: a fatal folly?', *Reuters*, 6 May 2009.

inequities which have far greater repercussions than just growth.

Arguments against land reforms in Pakistan and elsewhere have become legitimized, mainly by economists, but also by other categories of social scientists (and of course the landowners themselves), on the basis of different types of empirical evidence. While land reforms, which mainly imply the redistribution of land from large landlords to small or landless farmers or distributing state-owned land to landless farmers, may not increase overall growth, in some cases, large, corporatized, highly capitalized landholdings have been shown to do so. According to this argument, rather than break farms down in size, it is better to consolidate and mechanize.

Other reasons why land reforms are not supposed to be on the political agenda is that due to inheritance laws in Pakistan, land has already, over the generations, been fractured and made smaller, in all categories of landholding. The average farm size in Pakistan has also fallen markedly over the decades, as one would expect, and will continue to do so over the next few decades. Moreover, arguments are also made that relations of production are also no longer feudal, and hence there is no need to undertake land reforms. They also argue that the process of urbanization is doing away with large landholdings, and that it is just a 'matter of time', when most of Pakistan will become urban, relegating the issue of rural land.

Sadly, for all these reasons, some political parties in Pakistan have bought into this empiricist logic and do not consider even raising slogans about land reforms which, while unlikely to be ever fulfilled, demonstrate an understanding of issues and explanations of social inequity and injustice. As a consequence, land reform has become a little *passé* on Pakistan's political map.

One could, of course, wait another half century when the process of inheritance would have fractured the size of holdings even further and urbanization would have made much rural land redundant, giving rise to a Malik Riaz-type phenomenon demonstrating the power of urban land. By then, possibly, there might even be a tax on agricultural incomes, and perhaps a little bit of education and some understanding about justice and equality about women. But left to a natural process, some of this might never happen.

Intervening in what is the source of so many of Pakistan's problems in rural areas will not only speed up the eventual outcomes, but will also provide some sense of justice to those who will benefit, three generations sooner. Moreover, there are also empirical studies which show that land reforms actually increase a country's economic growth, especially if agrarian reforms accompany land reforms. Studies have shown that land reforms had a significant and positive impact on income growth and accumulation of human and physical capital. Land reforms have also been seen to have a positive impact on equity.

The power of land extends far beyond the horizons of the landed estate and externalities of large holdings are many. Despite the evolving changes which have taken place in Pakistan's agrarian economy and in landownership, the demand for land and agrarian reforms are just as pertinent today as they were three or four decades ago. They ought to be always high on the agenda of every political party, as an option worth implementing, particularly by those who promise a break from the past.

5.8 Summary and Further Reading

5.8.1 Summary

Having presented a history of agriculture in Pakistan in the previous three chapters, in this chapter we have reviewed the agricultural sector as it is today. We have examined the main trends in output, production, irrigation, etc. over the last six decades and more, and seen how this sector has evolved. From being the dominant contributor to GDP in the 1950s, the agricultural sector today contributes half than the services sector and even less than industry. Hence the often-repeated claim that 'Pakistan is mainly an agricultural country' is questionable based on this evidence. While agricultural production has increased over the last six decades, there has been somewhat of a reversal in these trends in recent years, which should be cause for concern. From peak production years in the mid-1980s, the index of agricultural production for all crops has varied quite dramatically. There is a growing belief that agriculture is in the throes of a serious crisis, and that drastic measures need to be undertaken to enhance output, arrest waterlogging and salinity, and bring forth another Green Revolution reminiscent of the agricultural changes in the mid-1960s.

A number of bad policies may have been responsible for creating this crisis. Economic incentives were not given to farmers, as they were expected to subsidize urban consumers and continue to increase output despite a lack of adequate pricing policies. Mechanization was heavily biased against the smaller farmers in favour of the large and very large producers. This was despite the fact that, as shown in Chapter 4, the structure of ownership and mode and means of production had undergone a radical transformation, with smaller farms emerging at the expense of larger farms. Credit to farmers continues to be a weak link in the input–output chain, where higher rates from the informal sector affect the small farmers. Moreover, overall credit to farmers is insufficient, and far less than can be justified. While direct production-related issues like types of seeds and salinity may have affected agricultural output, some of the ancillary inputs such as credit and guidelines such as pricing signals may also be a cause of poor performance. Finally, without meaningful land and agrarian reforms, many of the problems in Pakistan's agricultural sector will go unaddressed.

One must also recognize two new, interlinked, trends in the rural/agricultural sector, which bear repeating. Firstly, that the urban-rural divide is getting narrower and is diminishing, and secondly, that all rural is not exclusively, or even primarily, agricultural. Both these facts will have a crucial impact on the future of agriculture and agrarian relations in Pakistan. Today, the non-agricultural rural sector generates nearly 60 per cent of total rural incomes. Moreover, remittances, both domestic and foreign, are also an important supplement to the income of those who live in areas designated as 'rural'.

Issues of rural poverty and inequality—discussed at length in Chapter 22—are not only linked with landownership and agricultural production, but now have other causes as well which need to be understood and highlighted. A World Bank study of 2007, concluded that,

> although agriculture is at the heart of the rural economy, the majority of Pakistan's rural poor are now neither tenant farmers nor farm owners. Farmers (including both owners and tenants) comprised only 43 per cent of households in the bottom 40 per cent of the rural per capita expenditure distribution in 2004–05. Non-farm households (excluding agricultural labourer households) accounted for slightly more than half (52 per cent) of the poor. Overall agriculture (including both crop and livestock production) accounts for only about 40 per cent of rural household incomes; the poorest 40 per cent of rural households derive only about 30 per cent of their total income from agriculture'.[56]

Agrarian policy and reforms, need to take cognizance of these trends and changes. Box 5.14 offers a response by the Panel of Economists set up by the Government of Pakistan to address some problems in the agricultural sector. Also see Appendix 5.6 for an earlier response to Pakistan's agricultural problems.

5.8.2 Further Reading

Many of the contemporary issues facing the agriculture sector are discussed frequently in newspapers and magazines, and these are an important source for more information and understanding of the sector (see Appendix 5.5). With taxation taking on more importance lately, numerous articles, almost all in favour of agricultural taxation, appear in the press regularly. Other than newspapers and magazines, a few books and reports discuss the key issues facing agriculture in the past and today. These are:

Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984); Ijaz Nabi et al. *The Agrarian Economy of Pakistan: Issues and Policies* (Karachi: Oxford University Press, 1986) are two good references.

Two reports by the Government of Pakistan are also very useful: *Report of the National Commission on Agriculture, 1988* and *National Taxation Reforms Commission: Final Report*, 1986.

Some publications since 1999 are also very useful in this regard and should be consulted.

Mahmood Hasan Khan's 'Agricultural Development and Changes in the Land Tenure and Land Revenue Systems in Pakistan', in Khan, Shahrukh Rafi, *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999), summarizes many important issues. In addition, the Mahbub ul Haq Human Development Centre's Report, *Human Development in South Asia 2002* (Karachi: Oxford University Press, 2003), focuses on agriculture and rural development in Pakistan and the region, as does Akmal Hussain's *Pakistan National Human Development Report 2003* (Karachi: UNDP/Oxford University Press, 2003).

Innovative Development Strategies (Pvt), *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009), is recommended for examining the rural financial market in Pakistan. PILDAT in Islamabad has produced a Briefing Paper: *Taxing the Agriculture in Pakistan*, Briefing Paper No 42 (Islamabad: PILDAT, November 2011), which summarises many of the debates pertinent to taxation in agriculture. Professor Mahmood Hasan Khan two books which examine the role of rural development and community participation are: *Community Organizations and Rural Development: Experience in Pakistan* (Lahore: Vanguard, 2001); *Participatory Rural Development in Pakistan: Experience of Rural Support Programmes* (Karachi: Oxford University Press, 2009); *Agriculture in Pakistan: Change and Progress 1947–2005* (Lahore: Vanguard, 2006), contain many of his seminal articles over the years. See also Panos South Asia, *Leveling the Playing Field: A Survey of Pakistan's Land Reforms* (Kathmandu, Nepal: Panos South Asia, 2011).

Box 5.14

Institutional Framework for a Small and Medium Farmer: Agriculture Growth Strategy

The Panel of Experts set up by the Government of Pakistan in 2010 came up with some suggestions of addressing the problems in the agricultural sector.

An important factor in the current economic crisis is the food deficit and the underlying stagnation in yield per acre of major crops. (In the year 2007–08 crop sector growth was negative.) It can be argued that if the yield potential of the small and medium farm sector (less than 25 acres) is achieved, food shortages can be converted into food surpluses. In the existing high prices of food grain in the international market, such a shift can enable Pakistan to convert its weakness into its strength: The current crippling economic burden of food imports can be converted into a strength through food exports. To bring about this transformation a new policy framework is required to shift from the earlier elite farmer strategy to a new small farmer growth strategy.

When the 'Green Revolution' technology became available in the late 1960s it was possible to substantially accelerate agriculture growth through an elite farmer strategy which concentrated the new inputs on large farms. Now the crucial determinant in yield differences became not the labour input per acre in which small family farms had been at an advantage in earlier decades, but the application of the seed-water-fertilizer package to which the large landlords with their greater financial power had superior access. Thus the 'Green Revolution' had made it possible to accelerate agriculture growth without having to bring about any real change in the rural power structure. Today, after almost four decades of the elite farmer strategy, the imperative of land reform is re-emerging, albeit in a more complex form than before. As the large farms approach the maximum yield per acre with the available technology, further growth in agricultural output increasingly depends on raising the yield per acre of small farms and reversing the trend of land degradation brought about by improper agricultural practices.

The small and medium farm sector whose yield potential remains to be fully utilized, constitutes a substantial part of the agrarian economy. Farms below 25 acres constitute about 94 per cent of the total number of farms and about 60 per cent of the total farm area. From the viewpoint of raising the yield per acre of small and medium farms (i.e. farms of less than 25 acres) the critical consideration is that 15.7 per cent of the total farm area in the less than 25 acre farm category is operated by landless tenants. Another 13.07 per cent of the farm acreage in less than 25 acre farms is operated by owner cum tenant farmers. Since tenants lose half of any increase in output to the landlord, they lack the incentive to invest in technology which could raise yields per acre. Because of their weak financial and social position they also lack the ability to make such investments. Their ability to invest is further eroded by a nexus of social and economic dependence on the landlord which deprives the tenant of much of his investible surplus.

This problem is further exacerbated by the absence of an efficient land market where productive land can move to the more efficient operator. Institutional changes are required to enable flexible and secure tenancy contracts, and a competitive land market which can allow efficient operation of farmland.

The objective of raising yields in the small farm sector is inseparable from removing the constraints to growth arising out of the institutional structure of tenancy. A policy initiative that enables the tenant to acquire land is therefore an essential first step in providing the small farmers with both the incentive and the ability to raise their yields/acre.

State Land for the Landless

An initial step in providing productive assets to the rural poor could be to allot the available 2.6 million acres of state-owned land to the landless. This cannot be seen as a substitute for a land reform programme of 'land to the tiller'. According to the Census of Agriculture 2000, there are about 4.97 million acres of private farm area under pure tenant cultivation in farms below 25 acres. It is this acreage that would need to pass into peasant ownership for a genuine land reform to occur. Nevertheless 2.6 million acres (assuming that all of it is cultivable) could make a significant contribution to the reduction of rural poverty. For example if the 2.6 million acres of state-owned land were to be transferred to landless farm households in holdings of 5 acres each, then as many as 520,000 tenant farmers would become owner operators. This means that out of the total number of tenant farmers (about 897,000) in the less than 25 acre category, as many as about 58 per cent would become owner operators.

However, it is important to recognize that providing ownership of land to the landless is a necessary but not a sufficient condition for alleviating their poverty. Enabling the landless to make the transferred land cultivable, to actually settle on the new land and to achieve a sustainable increase in their income, productivity, and savings are equally important factors in making the scheme successful.

Source: Final Report of the Panel of Economists, *Medium Term Development Imperatives and Strategy for Pakistan* (Islamabad: Planning Commission, Government of Pakistan, April 2010), 90–91.

Appendix 5.1

Problems in Pakistan's Agriculture

In an article published in September 1996 in a local newspaper, Muhammad Ilyas presented the main arguments from a World Bank report on Pakistan's agriculture. This appendix is an edited version of Muhammad Ilyas's newspaper report.

> The World Bank in a recent report on the grave environmental situation in Pakistan has recommended enforcement of genuine land reforms as an essential measure to ensure sustainable exploitation of the natural resources including land and water. The report 'Pakistan: Economic Policies, Institutions and the Environment' prepared by Rashid Faruqee and Jonathan Coleman, said that giving ownership to farmers would help protect the environment. Land redistribution among cultivator farmers also eliminates chances of voter-exploitation by landlords. However, as Faruqee and Coleman have pointed out in the report, 'Because the laws in Pakistan were lax and easy to circumvent, past land reforms did not bring about the desired change in land tenure and did not have any effect on environmental protection.' 'Redistribution of income and wealth has an effect on the environment', they stress.
>
> Poverty and population growth have contributed to the degradation of the environment in Pakistan, where they have caused soil degradation, deforestation, rangeland degradation, marine and coastal zone damage, and many forms of urban and industrial pollutions. 'Short time horizons are not innate characteristics, however, but are the outcome of policy and institutional and social failures', the report points out.
>
> Poor farmers face very high production and financial risks that are often the result of misguided policy interventions in factor and product markets or insecure land tenure. Many poor farmers with below subsistence holdings are unable to afford the mechanism available for coping with risks, such as selling stored crops, credit and crop insurance, and have limited access to extension and market information. In many cases, they have no choice but to over-exploit the available natural resources.
>
> These misguided policies are at the roots of many serious environmental problems. Take salinity for example. Surveys have shown that three-fourths of tube wells provide brackish water that is unfit or only marginally fit for agriculture, resulting in salinity. Most of these tube wells are set up with subsidies and have been running these on subsidized electricity and selling the water at rates much higher than what is paid for canal water.
>
> On the basis of farm-level data, it has been estimated that yield losses in wheat as a result of sodic irrigation water were 9 per cent and 20 per cent in two different locales in the central Punjab. Experts have also estimated that crop yields are reduced by about one-third for crops grown on slightly saline areas and that yields on moderately affected areas are reduced by about two-thirds. Crop production of any kind is difficult on highly saline soils, the report has pointed out.
>
> Another instance of influential landlords laying their hands on government funds is the subsidy on application of gypsum. The government undertook a programme to popularize gypsum in order to combat the salinity that is caused by low-quality tube well water. A similar programme was very successful in the Indian Punjab, where the problem of salinity has been drastically reduced through the use of subsidized gypsum. There are, however, no data on the effects of the Pakistani programme. Field experience indicates, however, that in most instances, influential landlords were the main beneficiaries of the subsidies. Moreover, the report observes, application of gypsum to fields has not always followed disbursement of subsidies, because of rent-seeking behaviour. In other words, the subsidy money was misappropriated.
>
> Waterlogging is also a function of a faulty water rate system which the conglomeration of big landlords and the bureaucrats does not allow to be changed at all. As the report also remarks, underpricing of water and the complicated system of assessing water rate liability eliminates incentives to use water efficiently and has aggravated waterlogging and salinity.
>
> The structure of water pricing provides no incentives for using canal water efficiently, and discourages investments in water conservation, such as drip or sprinkler irrigation systems. Capital intensive agricultural practices are other characteristics of absentee landlordism. Facilitated by factor price distortions, these lead to the adoption of production methods that do not reflect factor endowments. Subsidies or targeted credit for tractors and threshers, to which again only the big landlords have access, have displaced labour, for example.
>
> The indiscriminate use of agricultural chemicals, such as fertilizer and pesticides—which small farmers with 93 per cent of farms but representing only about 41 per cent of the cultivated area cannot afford—has contaminated ground- and surface water. Their use in Pakistan's irrigated agriculture has expanded rapidly over the past twenty years. Excess nutrient loading as a result of fertilizer run-off can lead to uncontrolled algae growth.
>
> The widespread use of often dangerous pesticides on the cotton crop is associated with several potential health hazards, including contamination of workers who apply it (three-quarters of producers use a back-pack sprayer and no protective clothing), harvesters (all of whom are women), soil and groundwater used for drinking, and consumers of agricultural products. Summarized evidence from blood tests shows that as many as one third of cotton workers in Pakistan have been exposed to dangerous levels of pesticides, according to the report.

Source: Ilyas, Muhammad, 'IBRD Proposes Land Reforms', *DAWN*, 12 September 1996.

Appendix 5.2

Appendix 5.2
Summary and Time Frame for Structural and Policy Reforms in Agriculture

Policy area	Objectives	Measures	Proposed timing of initiating measures and expected implementation period
Incentives	Market-determined output prices	*End subsidy on wheat imports	1994/5, short run
		*Remove wheat and flour import restrictions	1994/5, short run
		*End support prices for sugar cane	1994/5, short run
		End support prices for all other crops	1995/6, medium to long run
		Initiate study into alternative means of reducing volatility of agricultural prices	1994/5, short to medium run
		*Build up enabling environment for private sector entry into storage and distribution	1995/6, medium run
		Regulation of processing industry where necessary	
		*Complete trade reform	1995/6, medium run
	Trade policy reflecting comparative advantage	Remove export taxes, import duties, and quantitative restrictions	1995/6, short to medium
		Extend income and wealth tax to agriculture	1994/5, short run
	Efficient and equitable tax system	Eliminate all agricultural tax exemptions Update tax base in agriculture by review of Producer Index Units	1994/5, short run 1994/5, short run
		Installation of mechanism for periodic review of Producer Index Units	1995/6, short to medium run
Input markets	Private sector production and distribution of commercial inputs	*Privatize urea production and distribution	1994/5, short run
		Divest National Fertilizer Corporation, including plants operated by its subsidiaries	1994/5, short to medium run
		*Expedite privatization of phosphate imports	1994/5, short run
		* Level playing field between public and private sector in input markets	1995/6, short run
		*Commercialize seed corporations	1994/5, short run
		Privatize seed corporations	1995/6, medium run
		Strengthen seed certification process	1994/5, medium run
	Market-determined input prices	Remove subsidy on electricity	1995/6, medium run
	Reform the irrigation system	*Decentralize irrigation system based on water user associations, public utilities, and market in water rights	1995/6, medium
		*Raise irrigation charges	1994/5, short run
	Remove distortions in land markets and reform credit provision	Initiate a study of land reform	1994/5, short run
		*Improvement and computerization of land records	1994/5, medium run
		Clamp down on delinquent loans and end cheap loans for machinery purchase	1994/5, short run
		End directed credit	1994/5, short run

Appendix 5.2 continued

Policy area	Objectives	Measures	Proposed timing of initiating measures and expected implementation period
Government expenditure	Reorient public expenditure towards changing needs of agriculture and ehance efficiency of expenditure programme	Reduce burden of administrative expenses on research and extension budget and increase operational funding	1995/6, short run
		Introduce new research priorities including research on farming systems, growth-enhancing public goods, and the environment	1994/5, short run
		Induce private sector to undertake privately profitable research	1994/5, short to medium run
		Introduce patent protection for seed varieties	1994/5, short run
		Reduce duplication and increase co-ordination of research institution to minimize wastage of resources	1995/6, short to medium run
		*Reduce the number of front-line extension workers and replace them with fewer, better trained workers, more responsive to the needs of farming system and not just given corps	1995/6, medium run
		*Open consulting services by adaptive research institutes to better off farmers on a cost-sharing basis	1994/5, medium run
		*Extensive use of mass media and other group approaches for basic messages about available technology and better farming systems	1994/5, medium run
		Increase investment in education, including functional education of farmers	1995/6, medium to long run
		Remove subsidies on capital	
		Target developmental expenditure towards poor and marginal farmers	1994/5, short to medium run 1995/6, medium run
Poverty	Rural poverty alleviation	Develop participatory, community-based organizations	1995/6, medium run
		Ensure enforcement of tenancy protection	
		Price water at economic cost	1995/6, short to medium run
Environment	Environmental protection and sustainable development	Phase out sapling subsidy to encourage private sector participation in sapling market	1995/6, short to medium run 1994/5, short to medium run
		Regulate pesticide use	
		Provide incentives to use Integrated Pest Management	1994/5, short run 1995/6, medium run
		Create community institutions to manage local resources and common property	1995/6, medium to long run
		Encourage private and public sector investment in soil and water conservation	1995/6, short to medium run

*Element of high priority

Note: For implementation periods, short run implies 1 to 2 years, medium run 3 to 5 years, and long run 5 to 7 years.

Source: Faruqee, Rashid, 'Pakistan's Agriculture Sector: Is 3 to 4 per cent Annual Growth Sustainable?', *Policy Research Working Paper no. 1407* (Washington DC: World Bank, 1995), iii–vi.

Appendix 5.3

The Determination of Support Prices for Agricultural Commodities

How should agricultural support prices be determined?

Support prices for agricultural commodities can be determined either on the basis of the cost of production or by what is termed as the 'parity approach'.

The cost of production approach aims at guaranteeing a fair return of a certain crop to the farmers and establishing a balance between a number of competing crops so that an optimum cropping pattern is achieved. Subject to soil, climatic, and other agronomic conditions influencing crop substitution in certain areas, cropping patterns can be moulded to correspond to planned production targets. For instance, wheat competes for area with both cotton and rice so a certain balance between the prices of the three commodities can help in attaining their required production levels.

However, there are certain problems in the cost of production approach. Agricultural production requires a number of inputs which are not marketed and whose valuation will, therefore, present difficulties. Such inputs include labour, management, and land. Labour and management costs, which should be the share of the entrepreneur, are difficult to assess. Similarly land rent, which may be the single largest cost item, is difficult to determine in a country where there is no organized land market.

The regional variations in physical resource endowments also have to be taken into account in the choice of samples for calculating cost. Moreover, with rise in prices, the cost of production has to be periodically adjusted.

The cost of production is also related to technology. For purposes of price support the cost of production may either pertain to old traditional technologies, which means a higher level of support price, or to the new technologies where costs may be low. A support price based on the new technology cost structure will have adverse equity effects particularly if the new inputs are subsidized or a large number of farmers have no access to the new technology. Large holdings with lower production costs may get higher net returns compared to small holdings. Thus the higher the support price, the greater the transfer of income to large holdings from the general revenues. It is now believed that the support price programme in Pakistan has operated in contradiction to the original intent of better income distribution among various segments of the rural farm sector since, mainly, the cost of production approach has been followed while determining the structure of support prices.

In addition to the problem of identifying the technology and the cultivators using that technology, there is another question: which cost should be taken into consideration? Average or incremental? In a production system as varied as Pakistan's agriculture in technology as well as scale, both types of unit costs are bound to create complications.

The 'parity price' approach is used in order to correct imbalances in terms of trade between the agricultural and the non-agricultural sectors. The 'parity price' is an output price that will yield income which will buy the same quantity of other products as it would in some specified based period. Thus a balance can be maintained between the prices of commodities sold by the farmers and the commodities which they purchase. It can be calculated through a comparative index of agricultural and non-agricultural prices. In this approach, the effects of inflation which keep upsetting the income and expenditure structure of the farm household are accounted for. Although it is free from the usual objections of lack of scientific rigour and bias in favour of transfer of resources to a particular category of landholding, the choice of the base year for working out the parity ratio may introduce some distortion in the income distribution pattern of different tenure and size farm categories.

The choice between the two approaches depends upon the relative importance of various objectives of the price support programme. If the major objective is providing production incentives for particular crops or crop combinations, the cost of production approach may serve the purpose at least in the short run. Parity prices, on the other hand, provide a range within which prices may be located in order to reflect the influence of the forces of demand and supply as well as the long-run objective of equity between urban and rural sectors.

In addition to the two approaches mentioned above, three other criteria are sometimes used for determining support prices: (i) open market prices; (ii) inter-crop parity index; and (iii) world prices.

An assessment of the open market price, as determined by the supply-demand interaction, is essential and should be kept in mind while making decisions regarding the support price. It serves as a retraining factor since too much deviation from the open market price may make the price support programme unrealistic and ineffective. It is, however, difficult to make an accurate assessment of the open market price since the markets are highly imperfect, unstable, and dominated mostly by a few buyers (*arhtis*/sugar mills). In fact, an agricultural price policy itself represents an attempt to escape from the uncertainties and distortions of the so called 'open market'.

The inter-crop parity index reflects the relative positions of various agricultural products and the rates at which these are exchanged. Their main utility lies in monitoring the use of scarce resources for competing crops and calculating optimal resource allocation.

World prices are relevant in the case of export commodities or those commodities which are partly supplied from abroad. But world markets are not equally competitive for all commodities. Their use is further restricted by the fact that while a certain product and some of the inputs (for example, pesticides and fertilizers) may have relevance to world market conditions, major elements in the cost structure (for example, canal water and labour) may have no linkage.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 179–80.

Appendix 5.4

A Bumper Wheat Crop! Shouldn't we Celebrate?

Wheat harvesting is round the corner. It has in fact already started in southern parts of the country. It is likely to be a bumper crop. The production estimates show that country will cross the 24 million ton mark. It may actually produce an unprecedented and all time high 25 million ton. This will make us a self-sufficient country in this vitally important food crop. Shouldn't we celebrate this achievement? Policymakers are confused; traders perplexed and farmers worried. This is how the agriculture is in this overly globalized world, where less means more opportunities to earn and more can spell disaster.

Pakistan has almost always remained wheat-deficient. Both the acreage and the per acre yield of wheat have never been enough to feed its burgeoning population. Yield hovered around 400 kg per acre till 1967–68. The so called green revolution pushed it up. It now stands at 1160 kilogram, which is still less by the international standards. The average yield in the neighboring Indian Punjab is 1680 kg per acre. The area on which wheat is cultivated in Pakistan has also doubled over past 60 odd years, yet we walk the tight rope.

Perhaps low yield is less a result of 'technological backwardness' of our farmer than of lack of incentive for growing this crop. Wheat is a food security crop and farmers work against heavy odds to secure enough for the family. They cannot dare to co-opt it. But they do not also see any incentive in going beyond this point in a big way. Wheat trade is dominated by the government which is the biggest buyer of the home production and also enjoys the authority to set its price. Farmers hardly ever find the wheat Support Price attractive enough to invest more resources into this crop and produce the surplus required to feed the non-grower population of the country. Overall production in recent years has swung between 17 and 23 million ton. The government of Pakistan is a frequent visitor of wheat selling markets of the world. It fills the supply gap through expensive imports and has been lamented tor offering far more to farmers of other countries than it does to its own.

Wheat price in Pakistan has traditionally been lower than the international prices. It is set on the basis of calculations made by Agriculture Pricing Commission that claims it considers input costs, inflation rate, etc. It however always falls below the expectations of farmers and has remained stagnant for years. It remained Rs. 240 per 40kg for three consecutive years, 1997 to 99, and then Rs. 300 for next four years. It was in a way reflective of the political importance of wheat farmers in our economy.

International market on the other hand is more influenced by the demand and supply perceptions and the 'expert' forecasts of future. Commodity prices, including wheat, peaked to unprecedented high levels during last year alongside the prices of petroleum products. This weighed heavily against our government's reliance on wheat imports to fill the demand-supply gap. To spur home production it raised the wheat Support Price by a hefty 52 per cent. It moved from Rs. 425 per 40kg in 2006–07 to Rs. 625 in the next to Rs. 950 for the current. The farmers' response obviously has been overwhelming and they promised a bumper crop.

The international market however has pulled the rug from under the government. The wheat prices that rose hand in hand with petroleum have tumbled down. US wheat (FOB, Gulf) was quoted at $454 per ton in March 2008. It now stands at $241 and is expected to go down further as harvesting in South Asia starts. The government of Pakistan's announced price for purchase of local wheat translates into over $300 per ton. This makes it a unique year for the local price is higher than the international price for the first time ever. So who will buy wheat from Pakistani farmers at the government price?

Why the private buyers will keep off?

Private buyers will most likely keep out at least until it gets out of the government hands and the price crashes. It does not make good business sense to buy at higher rates when it is available at much lower price just across the Gulf. The much publicized smuggling to Afghanistan will also stop automatically. In fact we could see reverse-smuggling if the international prices fall further; that is cheap international wheat bought for Afghanistan may find its way to the silos of the government of Pakistan. Businessmen however will be keenly watching the government procurement drive and will wait for their chances of breaking deals at 'good rates'.

This leaves the government alone with the onerous task of fulfilling its promise of buying wheat at the announced price of Rs. 950 per 40kg. The government has exhibited the will to oblige but how much can it buy?

Punjab is not only the biggest producer of wheat in the country, it is the only surplus producing province. 8 in every 10 kilograms of wheat produced in the country come from this province. Punjab Food Department is the biggest wheat buyer. It comes under the provincial government. Pakistan Agricultural Storage and Supplies Corporation (PASSCO) is the other big buyer. This comes under the federal government.

The two departments set procurement targets each year and fail to achieve them many times as farmers prefer private buyers who offer premium over Support Price. But this time as the private buyers will abstain, it will be an advantage to win a procurement promise from the government buyers. The favour is likely to become the new currency of political patronage, Punjab is already divided into constituencies of the two main political parties, one ruling at the federal level and the other at the provincial and both refusing to come to terms with each other. Juxtaposition of political constituencies over the jurisdictions of the two procurement authorities may level a new battleground for the two political heavyweights.

Aside from the politics, the government departments do not have the capacity to pick the entire tradable surplus of wheat. The Punjab Food Department has set a 3.5 million ton procurement target, while media reports put the same for PASSCO at 1.5 million ton. Rs. 111 billion has been earmarked for Punjab Food Department and Rs. 40.5 billion for PASSCO, The amount is being released by a consortium of banks.

The government planners consider only 30 per cent of total production as the tradable surplus. It is a rule of thumb that needs verification. Even at this percentage the current season's bumper crop will produce a surplus that will be much more than the procurement targets of the government.

Who will buy this leftover? The private buyers will make a heyday when a gasping government will be sitting over its brimming silos.

Who will suffer most in a price crash?

Wheat is grown by all farmers irrespective of the size of their farm. According to Agriculture Censuses 2000, 8 in every 10 farming families of the country dedicate a portion of land to wheat cultivation. In Punjab, nine; NWFP, eight; Sindh, five; and in Balochistan, four in every 10 farmers grow wheat. In Rabi season almost 6 in every 10 cultivated acres of the country come under wheat cultivation. All the three provinces except Punjab are wheat deficient.

According to the last census around 69 per cent of Punjab families live in rural areas. Almost half of these (53 per cent) have some access to land. They either own a farm or have rented one on different terms. The rest are landless laborers or are attached to services and other sectors.

Access to land within these around 4 million owners and/or tenants is highly skewed. Average access of more than half of these (56 per cent) is just 2.1 acres. From the point of view of wheat production, the Punjab farmers can be divided into four broad categories. Here are the details:

1. Very small farmers
Around a third of Punjab farmers own on an average just 1.2 acres of land. They are more than 1.3 million in number and cover almost their entire area (1.1 acres) with wheat in Rabi season. Their share in total wheat production of the country is just 7.4 per cent. Their produce is hardly enough for the family itself. In fact, to ensure this, they have to harvest it themselves and avoid hiring labour for any other field job as well. This effectively means that they themselves consume their entire production and generate no surplus for trade.

2. Small farmers
A little more than half of Punjab fanners own (and/or rent) 5.8 acres on average. These around 2 million fanners cultivate wheat on 4 acres of their land. Their share in Punjab's total output is 47 per cent. After saving enough for family consumption and seed, they pay a considerable amount to groups of harvesters in kind and also oblige the service providers of the village called saipee. Since the small farmers form the biggest farming group, they are able to contribute 41 per cent in the province's entire tradable surplus of wheat.

3. Medium farmers
These over five hundred thousand farmers of Punjab have on an average access to 20.5 acres of land and dedicate over half (11.8 acres) of this to wheat. The second half is occupied by other Rabi crops most of which are grown for cash, The medium farmers produce 35.5 per cent of the province's entire wheat. As they too save tor family and seed and pay for services in kind, their share in tradable surplus of Punjab wheat stands at 45 per cent.

4. Big fanners
They are around 50 thousand in number and their landholding size on average is 86 acres. Ihcv cultivate wheat on less than half (45 per cent) of it. They produce ten per cent of Punjab's wheat and their share in tradable surplus, according to estimates, is around 14 per cent of the total surplus.

The government experts calculate the overall tradable surplus of wheat as 10 per cent of total production. We have serious reservations about it and our estimates put the surplus at much higher level. Even if the official rule of thumb is accepted, a bumper crop of 25 million ton will produce a tradable surplus of 7.5 million ton. In Punjab the collective procurement target of Punjab Food Department and PASSCO falls short of the expected tradable surplus. The departments will leave at least million ton with the farmers. The government can in fact achieve its procurement target by starting with buying the produce of big farmers and ending with that of the medium ones. Who will buy the surplus produced by the small farmers? The private parties cannot be expected to pay at par with the government in the present international scenario. These two million small farmers, who have grown wheat on four acres each, risk humiliation at the hands of private buyers. And we are fast running out of time. They grow almost half of the province's total wheat and a big loss in this year is bound to negatively affect their contribution the next season. According to careful estimates of cash input costs of current season, a Punjab farmer on an average has spent Rs. 628 on the production of 40kg wheat. This does not include land rent and self-labour.

What can be done?

The political government had for the first time ever dared to come face to face with the international market by pricing its wheat at par. The same however has upset the cart. We believe the government needs to tackle the issue on two fronts.

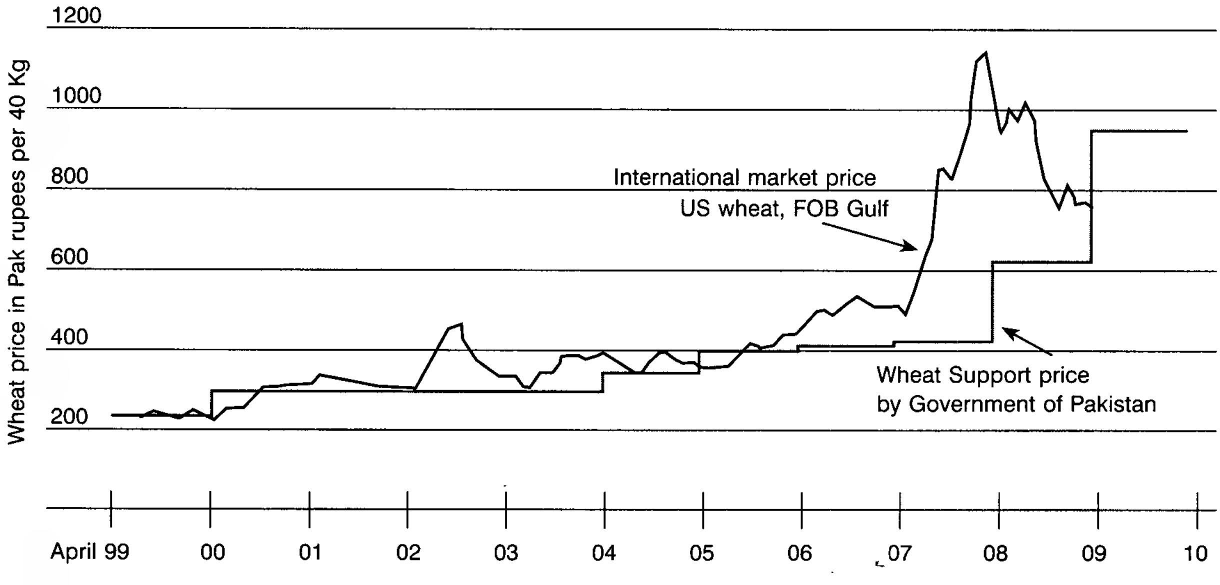
First and foremost it must act quickly to save its small farmers from destruction. The government departments are given purchase targets which are then distributed among several of their purchase centers. Performance of each is judged by what percentage of the target they have achieved. If we have to save the small wheat farmer, we need to ensure that the departments give priority to small producers. As is evident from the data, the smaller the farm size, the bigger is the share of wheat cultivation. Very small farmers, with an average farm size of 1.2 acres, sow wheat on 88 per cent of the land available to them, while big farmers, with an average access to 86 acres, cultivate wheat on less than half (45 per cent) of their land. This implies that the big and medium farmers grow other crops in the same season as well and are more able to sustain pressures on wheat, while for the small farmers this crop is a make or break matter. Moreover, small farmers with little clout are more vulnerable to maneuvering by private traders. Big farmers have storage facilities as well and they are not pushed to sell their produce then and there. They can wait

for the market to turn in their favour. Many times 'hoarding' by big farmers has caused the government difficulties in achieving its procurement targets. On the other hand cash-strapped small farmers have to sell their produce immediately after harvesting to keep their limited cash flow cycle intact. The government must ensure that small farmers are preferred by its departments in their procurement drive. It has to go beyond political rhetoric and develop a foolproof system. A crisis will be a big disappointment for farmers that will definitely reduce production in the coming season.

Secondly, the government needs to work with other governments of developing countries to look into the matters of international trade. Its high volatility is a cause of big concern for our small farmers. The temperamental global commodity market should not be taken as 'a natural phenomenon'. The governments of countries producing surplus for export unduly shield their farmers from the effects of market fluctuations. They ensure that their farmers get reasonable returns whatever way the market goes. This in fact encourages the market to waiver wildly as the risks of the primary producers are already effectively covered by their governments.

The governments need to effectively campaign against these policies of exporting countries to develop a rational global market. To discourage opportunistic traders from spoiling the announced procurement rate, the government shall levy duty on cheap wheat imports till at least the next harvesting season. It should ensure that international wheat is not available in the country cheaper than local wheat. This step will deprive the local traders the option of cheap imports and they might start buying local wheat at the government announced price. The government will have to be vigilant about the smuggling of wheat into Pakistan as well.

Source: Punjab Lok Sujag, *Wheat Economy Heading for Boom or Bust?* (Lahore: Punjab Lok Sujag, Farmer Report, April 2009).



Monthly international wheat price is for US No. 2 Red hard winter wheat FOB Gulf as quoted in UNCTAD database: rupee equivalent has been calculated using exchange rate quoted by National Bank of Pakistan. Treasury Management Division

Appendix 5.5

Taxes on Land and Farm Income

Professor Mahmood Hasan Khan assesses the taxation and land revenue structure in Pakistan.

The federal government has made no serious attempt so far to improve the structure of direct taxes in agriculture, which at present are mainly in the form of land revenue (tax) assessed and collected by the provincial governments. The modest yield from land revenue has no relation to the increase in agricultural incomes and the general rise in the value of land since at least the mid-1970s. Direct taxes contribute about 23 per cent of the total tax revenue of the federal and provincial governments. In 1994–95, the land revenue of Rs. 1.1 billion was around 1.9 per cent of all direct taxes collected in the country, falling from 4.7 per cent in 1980–81.

What is even more interesting is that the ratio of land revenue to the value-added by crops has declined from 3 per cent in the 1950s to 0.58 per cent in 1980–81 and 0.45 per cent in 1994–95. Put it differently and the direct tax (land revenue) paid by farmers works out to Rs. 51 per hectare of cultivated land in 1995. Using a conservative figure of Rs. 3,000 per hectare for net crop income (after cultivation expenses), the average land tax is around 1.7 per cent of a farmer's income. The contribution of land revenue to the provincial taxes and provincial revenue has fallen significantly: land revenue used to contribute 30–55 per cent of the provincial taxes during the first 25 years of Pakistan (1947–1972), but has contributed 8–14 per cent in the last 25 years. Likewise, its contribution to the provincial revenue has decreased from 13–16 per cent to 6–11 per cent in the two periods.

The agriculture sector has been taxed heavily by the government's pricing policies and taxes on exports of agricultural products. These policies have (i) transferred resources from agriculture to the rest of the economy; (ii) generated revenue for the governments; and (iii) distorted the allocation of resources. Price subsidies on agricultural inputs, though substantial over time, have not altogether offset the burden of hidden taxes on producers. While there is some doubt if these subsidies have contributed to increased farm productivity, it is certain that most of them have been appropriated by large and influential farmers (landlords).

It is absolutely essential to maintain a favourable macroeconomic environment for agricultural producers if we want additional resources for investment in physical and social infrastructure to help improve the living standards of those whose incomes and jobs depend on agriculture. One should strongly oppose policies that penalize agricultural productivity, including perverse policies on output and input prices, exchange rate, regulation and control of internal and international trade, farm credit, and investment in physical infrastructure, research and extension. In the last five years, the burden of implicit taxes on agriculture has fallen substantially as a result of significant changes in prices and structural reforms.

We should here distinguish clearly between two issues: (i) the tax burden on the agriculture sector and (ii) the tax on personal income and wealth, irrespective of the sector in which they are produced or created. The first issue has been addressed gradually in that there has been substantial reduction in the tax burden on agricultural producers. The second issue of taxing agricultural income has, however, remained unresolved because of the effective political power of the large farmers and landlords. All kinds of excuses and deceptive arguments have been used by this group or by others on its behalf.

The case for increased reliance on direct taxes on actual agricultural income, or on presumed agricultural income (based on land according to its productivity) is quite persuasive on several grounds: indirect and hidden taxes on agriculture adversely affect and hurt the wrong people and send wrong signals on the question of efficient allocation of resources; the government revenue from direct taxes is small and has declined relative to other tax revenue and agricultural income; interpersonal equity (fairness) in (direct) taxation is not well served by differentiating incomes for tax purposes by sector or activity which produces income; and the tax base has to be expanded and made more flexible in order to reduce the fiscal deficit.

At present there are only two forms in which the government taxes landowners directly and includes the revenue in its budget: (i) wealth tax on agricultural land as immovable property and (ii) land revenue as a tax on land that generates income. The former is assessed and collected by the federal government and the latter by the provincial governments. In 1982–83, the military government introduced the ushr levy on (Sunni Muslim) landowners in lieu of the land revenue, but the paltry ushr revenue has not been part of the government's budget. *Land revenue is still almost the only direct tax revenue collected from landowners.*

The tax on movable and immovable wealth was introduced in 1963, but agricultural land was exempted in 1970 from this tax for those landowners whose only source of income was agriculture. The value of land for wealth tax was set at Rs. 10 per Produce Index Unit (PIU), which was used as a relative measure of productivity of land parcels in different locations to set the land claims of Muslim refugees from East Punjab in the late 1940s and then in the implementation of the Land Reform Acts of 1959, 1972, and 1977.

The federal government has raised the assessment value of land from Rs. 10 to Rs. 250 per PIU since 1990, although the PML Taxation Committee in 1990 was in favour of raising it to Rs. 400 per PIU which is the basis for acquiring loans from the banking system. In 1993, the second caretaker government removed the wealth tax exemption of 1970 for the landowners owing mainly to the pressure of donor agencies. However, following the recommendations of the Prime Minister's Task Force on Agriculture in 1994, the PPP-led government introduced several generous deductions to dilute the effect of wealth tax on large landowners. Further, the federal government has not accepted the suggestion by donors that the number of PIUs per hectare should be revised as a measure of the value (productive capacity) of land for wealth tax purposes. It is obvious that, without raising the

assessment value of land to Rs. 400 per PIU and the upward revision of PIUs per hectare, the wealth tax receipts from agricultural land would remain inconsequential.

The land revenue system in Pakistan has a very long history, but in its present form it was concretized by the British colonial government in the Punjab Land Revenue Act of 1887. This system now has no redeeming feature: it is a relic of the past developed under the absolutist, authoritarian, feudal, and colonial regimes and maintained by the political influence of landlords and rich farmers since 1947.

The land tax has no merit now because of the ad hoc changes made in the rates and exemptions in the last 25 years after the West Pakistan Land Revenue Act of 1967 which replaced the Punjab Land Revenue Act of 1887 was extended on a uniform basis to all parts of Pakistan.

It is no longer linked to the presumptive (income) capacity of the land one owns, hence it is highly inequitable between landowners and between those who earn their income from agriculture and others whose income is earned from other activities. In addition, the land revenue produces a very modest income for the provincial governments in spite of the ad hoc increases in the rates in 1983/84.

There is a long history of opposition to the idea of taxing agricultural incomes, going back to the times of the British rule in India. With the passage of the Income Tax Act of 1886 agriculture was to have only the land revenue system. The Income Tax Act of 1922 granted specific tax exemption to agricultural incomes, which is still available in Pakistan under the Income Tax Ordinance of 1979. In the decade after 1947, successive governments were able to avoid the issue of taxation on land and agricultural income. In the next fifteen years, in spite of the strong recommendations of the Taxation Enquiry Committee of 1959, Taxation and Tariffs Commission of 1964 and Agricultural Enquiry Commission of 1972–74, the federal government did not replace the land revenue system by a system of tax on agricultural income.

A major breakthrough on the issue of taxation of agricultural incomes was the enactment of the Finance (Supplementary) Act of 1977 by the PPP government. This act abolished the land revenue and replaced it by a uniform and universal income tax in the country in January 1977. However, before the PPP government could start the implementation of the Finance Act of 1977, the military government which took over power in July 1977 first suspended and then cancelled the act. The former tax exemption on agricultural income was restored in the Income Tax Ordinance of 1979.

In the 1980s, at least three 'expert' bodies—National Taxation Reform Commission in 1986, National Commission on Agriculture in 1988 and the Committee of Experts on Taxation of Agricultural Incomes in 1989—examined the question of changes in direct taxes on agriculture, including land revenue, ushr, and income tax. The majority view was against introducing a tax on agricultural income mainly on the ground that the federal government was not empowered to legislate on matters falling in the provincial jurisdiction, except in a State of Emergency under Article 232 of the Constitution. They emphasized the need to improve the assessment and collection of land revenue and ushr, but without specifying the measures for implementation.

A minor policy reform with respect to agricultural income was introduced by the federal government in the Finance Ordinance of 1988. It amended the Income Tax Ordinance of 1979 to include agricultural income (if any) in the 'chargeable income' for determining the tax rate for non-agricultural incomes. This so called clubbing formula, introduced with the federal budget of 1988-89, has had no major impact on tax evasion and the income tax revenue. At the end of 1990, the PML government appointed a taxation committee, which was in favour of a tax on agricultural income, but it repeated the excuse earlier made by the three expert committees in 1986, 1988, and 1989. So the committee recommended that the federal government should redefine the concept of agricultural income by excluding the rental part received by landowners and incomes earned from orchards, livestock, and poultry farms. However, the PML government took no action on this recommendation.

The persistently high fiscal deficit and the pressure of the international donor community since the early 1990s have moved up the issue of reforming the land revenue system on the government's policy agenda in Pakistan. The caretaker government after the dismissal of the PML government in July 1993 acted on two fronts in September–October 1993. First, it removed the 1970 exemption for agricultural land for wealth tax purposes. Second, it issued ordinances in all provinces to introduce a flat tax rate of Rs. 2 per PIU on all landholdings above 4,000 PIUs to replace the existing land revenue. In February 1994, the newly elected PPP government enacted a somewhat watered-down version of the Wealth Tax (Amendment) Ordinance to justify the changes in the original legislation.

The elected provincial governments, however, did not follow up on the provincial tax ordinances on presumed agricultural income (based on PIUs) issued by the caretaker government in September–October 1993. The provincial assemblies of the NWFP and Balochistan have enacted the land tax legislation, introducing a graduated scale of tax on presumptive income expressed in rupees per PIU. However, the two provincial governments have apparently not started the implementation process. The provincial governments in the Punjab and Sindh have been dragging their feet and taken no concrete action to legislate and implement the new tax system on presumed income based on even unrevised PIUs per hectare.

At least two major steps are required immediately: (i) abolition of the current system of land revenue assessment and (ii) revision of the number of PIUs per hectare in all provinces, based on the existing productive capacity of agricultural land. If the presumed income tax on land has to serve as a fair measure of taxation, a source of increased government revenue to meet the development needs of the rural people, then the provincial governments must consider increasing and graduating the flat tax rate of Rs. 2 per PIU and reducing the basic exemption for the individual landholding in terms of the revised number of PIUs per hectare equivalent to no more than five hectares irrigated.

Source: Khan, Mahmood Hasan, 'Taxes on Land and Farm Income', *DAWN*, 8 June 1996.

Appendix 5.6

Getting the Policies Right in Pakistan's Agriculture

In another article, Prof. Mahmood Hasan Khan examines the key problems that face Pakistan's economy.

The economy's vulnerability to the performance of agriculture is based on its contribution to the supply of food and raw material, employment, and export earnings. These facts are well documented and need no further comment. What is, perhaps, less obvious is the (increasing?) burden on agricultural imports on the economy. The annual import bill on account of wheat, edible oils, sugar, pulses, and milk and its products is between $1.2 and $1.8 billion or around 15–18 per cent of the value of all imports. A high proportion of the food import bill is for edible oils ($800–900 million) and the rest for wheat and sugar.

Pakistan is importing this year probably 2.5 million metric tons or about 15 per cent of its expected wheat output. Perhaps a more distressing aspect of food security is that a sizable part of the supply of edible oil products, wheat, wheat-flour, and sugar find their way into the markets of neighbouring countries, thanks largely to price differentials and the low cost of these transactions to participants.

It is also well-known that much of the progress in agricultural production has come from the increased quantity of resources (inputs) and not from their increased efficiency (productivity). For instance, crop yields in Pakistan are among the lowest in the world, but mercifully have potential for significant increase. There is considerable evidence of waste of the key production resources, water and land, in most agricultural areas. Experts tell us the deterioration in the physical integrity of the irrigation and drainage system and quality of soils has become perhaps the single most important threat to the sustainability of agricultural growth in Pakistan.

Inadequate public investment, high cost of maintenance, and wrong-headed price policies have been rightly regarded as the major contributors to this problem.

A large part of the explanation for low productivity and waste of resources has to do with the rights to land and water and the state policies affecting incentives for a profitable agriculture. Successive governments have done either too little in areas that could significantly enhance agricultural production, or too much in others that have significantly debilitated the agriculture industry in Pakistan. Numerous committees/task forces/commissions—at least four since 1988—have reported on the problems of agriculture and made policy recommendations.

Constraints on agriculture go beyond the issue of price adjustments; they include structural and institutional problems.

There are clearly four policy areas that have a direct impact on the productivity and profitability of agriculture in Pakistan: (1) control of and access to (good) agricultural land; (2) access to and (efficient) use of irrigation water; (3) market structures for and prices of inputs and outputs; and (4) availability of public goods, including physical infrastructure and the support system of agricultural research and extension.

The idea of land reforms in Pakistan evokes little interest and much hostility, although it is at the heart of the problem of control and access to agricultural land. Property rights in land—or the responsibility to use it—need to be defined and protected to increase efficiency and check unfairness. The existing system of land titles is in a mess.

One has simply to look at the land records and the massive volume of intra-family and inter-family litigation for rights in land. The landlord-tenant contracts are more messy both in their written and verbal forms. In practice, they depend mainly on the power of one of the parties. The government's resources and efforts should focus on improving land titles and tenancy contracts with quick and fair dispensation of justice in disputes. The land revenue machinery, including revenue courts, is bloated in numbers but grossly inadequate in its effectiveness.

Prices

The access to water and its efficient use for agriculture is no less important in Pakistan. The existing irrigation system has almost no redeeming feature: rampant rent-seeking and neglect of the irrigation infrastructure are certainly its two most costly manifestations. An apparent paradox is that canal water is grossly underpriced from society's point of view and grossly overpriced from the viewpoint of the water user. It is, however, quickly resolved by looking at the rent-seeking system. On the surface, the case for an autonomous (private sector) irrigation authority is quite strong, but some of the underlying assumptions for its success seem dubious. The experience of the Water Users Association (WUAs) so far has not been encouraging, hence the problems associated with the On-Farm Water Management (OFWM) projects throughout the Indus Basin. The growth of genuine (participatory) organizations of farmers (water users) requires a socio-economic environment that the existing land system cannot provide. The proposed (autonomous) water utilities may turn out to be as serious a bottleneck to agricultural growth as the existing irrigation system has been. The water problem has to be resolved at the national level as well in terms of disputes between provinces on their 'fair' shares and 'leakages' experienced at critical times in each crop search.

Prices are (or can be) very strong signals for allocation of resources and profitability of the individual enterprise (farm). I am entirely in favour of price liberalization for both outputs and inputs, but policymakers have to take into account some of the side-effects such as redistribution of welfare (income) in the society. We are told almost ad nauseam that farmers want and should get 'fair' prices for their outputs, which the present price support system does not allow. The trade-off is that they may have to accommodate greater seasonal variability in prices. Governments and financial institutions can assist the private sector in developing storage systems that can stabilize prices.

The existing price support and procurement system should be abolished and support should be extended to private marketing channels for greater competition and investment in the distribution network for commodities. Consumers can and

should be protected by targeted (price or income) subsidies. Generalized consumer subsidies on wheat flour, sugar, and edible oils are a major source of cross-frontier trade or smuggling. In this regard, one should also seriously question the wisdom of maintaining the rent-seeking bureaucracy in the provincial food departments and a variety of parastatals at the federal and provincial levels. Is this really not a very costly way of providing subsidy to urban residents?

Subsidies

The case for price subsidy on agricultural inputs has never been too strong or persuasive since its co called incentive effect is more than offset by (i) waste and (ii) unfair distribution of benefits. The experience of subsidized credit is by far the best case to make this point. Targeted subsidies combined with greater access to credit for smaller farmers and rural entrepreneurs are the answer. Public sector financial institutions have proved to be a disaster since their activities have been dominated by political and not market forces. Innovative credit arrangements between private financial institutions and small-scale borrowers have to be expanded, particularly in those areas in which viable farmers (water users) organizations can develop. In some of the NGO-supported rural development programmes, this has already happened. Imported inputs, particularly machinery, should neither be taxed too heavily nor subsidized. Reduced customs duties on exports and imports seem to be the most reasonable approach to take.

There is finally the role of the government in building and strengthening the physical infrastructure and agricultural support services. Public investment in the irrigation, drainage, and road systems can have reasonably high rates of return provided the infrastructure (i) is based on good design and responds to the needs of people in different areas and (ii) has a reasonable cost recovery system. So far both of these aspects have been grossly neglected. Public investment in agricultural research and extension services can yield even higher returns.

However, the existing national and provincial systems must be restructured. The research system has to be brought closer to where the problems are and integrated with the delivery system to reach the intended beneficiaries. The army of front-line extension workers (field assistants and others) should be replaced by localized adaptive research outfits (establishments) to act as the meeting point for suppliers and recipients of technologies. In fact, a large part of the extension services can be done through these entities in collaboration with private sector companies and farmers (village) organizations. The cost saving from a significantly reduced size of the extension bureaucracy can be used to improve the research-based delivery system and rural education.

Governments are not being asked to do less but do things differently. Get your hands out where they tend to stifle economic activity and exacerbate income inequality and concentrate on policies—structural and institutional reforms included—and investment that contribute to economic growth and alleviate rural poverty.

May I add that a vibrant and productive agriculture will also (a) neutralize the oft-repeated arguments of the farm lobby against taxation of the incomes of the rich (large) farmers and landlords and (b) yield substantial tax revenue for public investment in the agriculture sector itself.

Source: Khan, Mahmood Hasan, 'Agriculture in Pakistan: Get the Policies Right', *DAWN*, Economic and Business Review, 31 March–6 April 1997.

NOTES

1. This includes income from the sale of goods (retail and wholesale), work done on raw material, repair and maintenance, transportation, commissions and fees, contractual work, the sale of food items, rent, services, construction, and others; remittances and revenue from livestock are also important for rural incomes. Source: Innovative Development Strategies (Pvt.), *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009), 17, 53.
2. Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981), 20.
3. Ibid. 21.
4. Ibid. 21.
5. Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1982), 79.
6. Faruqee, Rashid, 'Pakistan's Agricultural Sector: Is 3 to 4 per cent Annual Growth Sustainable?', *Policy Research Working Paper 1407* (Washington DC: World Bank, 1995), 6.
7. Ibid. 8.
8. Government of Pakistan, Ministry of Food and Agriculture, *Report of the National Commission on Agriculture* (Islamabad, 1988), 486–7.
9. Ibid. 487.
10. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 147.
11. Ibid. 149.
12. Ibid. 151.
13. Ibid. 155.
14. Government of Pakistan, *Report of the National Commission on Agriculture*, op. cit., 1988, 489.
15. World Bank, *Pakistan: Growth Through Adjustment*, Report No. 7118-PAK (Washington DC: World Bank, 1988), 37.
16. World Bank, *Pakistan: Country Economic Memorandum FY93I*, Report No. 11590-PAK (Washington DC: World Bank, 1993), 7–8.
17. A large part of the discussion in this section draws from the seven extensive Rural Financial Market Studies preliminary report prepared by the Applied Economics Research Centre, University of Karachi, conducted for the State Bank of Pakistan in 1994. The large surveys and analysis of the studies were being undertaken at the time of writing this book.
18. State Bank of Pakistan, *Rural Financial Market Studies: Phase* 1 (Karachi: SBP, 1994), 1–2.
19. World Bank, *Pakistan: Rural Finance for Growth and Poverty Alleviation* (Washington DC: World Bank, August 1995).
20. The full title of the study is: Tatiana Nenova and Cecile Thioro Niang with Anjum Ahmad, *Bringing Finance to Pakistan's Poor: A Study on Access to Finance for the Underserved and Small Enterprises (World Bank* DC: World Bank, May 2009).
21. All the data here are drawn from the above mentioned study.
22. Also see the excellent study by Innovative Development Strategies (Pvt.), *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009).
23. State Bank of Pakistan, op. cit., 1–2.
24. Ibid. 1.3.
25. Ibid. 2.1.
26. Ibid. 5.1.
27. Ibid. 5.4.
28. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 162.
29. State Bank of Pakistan, op. cit., 1994, 6.1.
30. Ibid. 6.2.
31. Ibid. 6.2.
32. Ibid. 6.3–6.4.
33. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 160.
34. Government of Pakistan, Agricultural Census Organization, *Pakistan Census of Agriculture, 1972* (Islamabad, 1976).
35. Government of Pakistan, Agricultural Census Organization, *Pakistan Census of Agriculture, 1980*, (Islamabad, 1983).
36. Government of Pakistan, *Report of the National Commission on Agriculture*, op. cit., 225–6, emphasis added.
37. Ibid. 226.
38. Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985), 48.
39. Government of Pakistan, *Report of the National Commission on Agriculture*, op. cit., 1988, 226.
40. Applied Economics Research Centre, *Impact of Tractors on Agricultural Production in Pakistan*, Research Report No. 20 (Karachi: AERC, 1982).
41. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 176–7.
42. Government of Pakistan, *Report of the National Commission on Agriculture*, op. cit., 1988, 536, emphasis added.
43. Government of Pakistan, National Taxation Reforms Commission, *Final Report* (Islamabad, 1986), 134.
44. Ibid. 137.
45. Ibid. 138.
46. Nasim, Anjum and Asya Akhlaque, 'Agricultural Taxation and Subsidies', in Nasim, Anjum, *Financing Pakistan's Development in the 1990s* (Karachi: Oxford University Press, 1992), 476.
47. Ibid. 476.
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49. This section is drawn largely from: Hussain, Akmal, *Pakistan National Human Development Report 2003*, (Karachi: UNDP/Oxford University Press, 2003), and Bengali, Kaiser, (ed.) *The Politics of Managing Water* (Karachi: SDPI/Oxford University Press, 2003).
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Part 2

Industry and Trade

There is a general belief amongst economists, policymakers, and the general public that industrialization implies economic growth and development. Unless countries industrialize, the assumption goes, they will continue to remain un- or underdeveloped. The progress of countries like South Korea, Taiwan, and other East and South-East Asian countries, which used to be called the Newly Industrialized Countries (NICs), only endorses that view. The first three chapters of this part of the book examine the process of development in industry in Pakistan, from the early days when very little existed. The extraordinary growth in industry in the 1950s and 1960s suggested that Pakistan might be one of the very few countries at that time which would join the developed world. However, much of the growth that had taken place in the first two decades soon unravelled, with growing income and regional inequalities, resulting in the separation of East Pakistan.

Pakistan after 1971 was a new country in many respects, not least because of the industrial and economic policies followed between 1972 and 1977. The role of the public sector was increased substantially and the economy, for numerous reasons, did not do as well as it had in the first two decades. However, as the discussion shows, most claims that the early 1970s were a disaster are factually incorrect. Just as much as there was a change in economic policy in the early 1970s, in the 1980s, too, there was another shift, in many ways similar to that of the earlier period, but also influenced by the new world order of globalization, privatization, openness, and neo-liberal economic policies. The Structural Adjustment Programme sponsored by the IMF and the World Bank determined much of what happened regarding industrial policy in Pakistan.

Chapter 8 evaluates the key issues in the industrial sector in Pakistan, and questions most of the myths that have been perpetuated over the last few decades. The claims that Pakistan's industry has been severely inefficient are not supported by the evidence. Many of the accusations made about the trade regime causing inefficient import substituting industrialization were also found to be false. Moreover, the claim that the public sector, too, was wasteful and inefficient in the past, is not borne out by the facts. These chapters offer a reinterpretation of the industrial and trade process in Pakistan, arguing that although there are problems in the industrial and trade sectors, many of the allegations made in the past, have been grossly exaggerated.

However, one must also add, that in 2013, Pakistan's industrial sector faced huge problems and extraordinary difficulties. The power crisis over the last five years and the consequences of the War on Terror, and other issues, have caused Pakistan's investment rate to collapse to its lowest level in many decades. Some of these issues are discussed in Chapter 8.

6 The Process of Industrialization in Pakistan I: 1947–77

For a region that was considered to be the Indian subcontinent's economic backwater at the time of partition, Pakistan's industrial and economic growth performance, at least up to the late 1960s, was phenomenal. Pakistan was considered a model developing country in the 1960s and enjoyed growth rates of gross domestic product (GDP) of over 6.7 per cent during the decade. This, in a country that was considered to be 'an economic wreck [with] serious social unrest rising'[1] as reported by the influential *TIME* magazine in 1947. Gustav Papanek, a professor from Harvard University, who played an important role as adviser to the Pakistan Planning Commission between 1954 and 1960, summarized the perception most observers had of Pakistan:

> At independence, Pakistan—simultaneously created and disrupted by the partition of British India—was widely considered an economic monstrosity. The country was among the poorest in the world and had no industries to speak of, almost no industrial raw materials, no significant industrial or commercial groups. It was difficult to see how Pakistan's economy could grow more rapidly than its population. Economic chaos and political disintegration seemed more likely. The 1950s were a period of apparent stagnation and mounting economic problems, when early dire predictions seemed to be fulfilled.[2]

The metamorphosis over a few years confounded all the prophets of doom who had predicted total anarchy in, and annihilation of, the country. By the mid-1960s the tone of dismay had changed considerably, and the international media had this to say about Pakistan: 'Pakistan may be on its way toward an economic milestone that so far has been reached by only one other populous country, the United States',[3] and 'the survival and development of Pakistan is one of the most remarkable examples of state and nation building in the post-war period'.[4]

This is the first of two chapters in which we examine Pakistan's industrial performance since 1947. The thirty-year period covered in this chapter consists of three very distinct, albeit interconnected, phases in industrial and economic policy. The first phase is the period 1947–58, when the foundations for the future years were laid. This was a period of huge change in the demographic make-up of the country, as well as in the political sphere, where governments were changed frequently.

The mere fact that the government had to deal with a refugee/migrant influx of about 7 million into West Pakistan (about 20 per cent of the entire population) was itself a massive responsibility and task. Add to that the fear of being taken over by India, and the lack of an industrial base or a skilled labour force, and we do indeed have every reason to believe the prophets of doom. However, Pakistan, despite heavy odds, did manage growth rates of GDP of more than 3 per cent per annum in the earlier years. In the first main section of this chapter we examine how commercial and foreign exchange policies helped guide the economy on its path. This phase was a classical, and fairly successful, implementation of import substituting industrialization (ISI).

There was a continuation of these economic policies, at least in general direction and principle, during the second period between 1958 and 1968, under the leadership of Ayub Khan. Growth rates continued to impress, and a substantial industrial and economic base was established. However, there were major differences between the two periods, not least regarding political control and stability. In contrast to the confusion and frequent changes in government in the first decade, the second decade represented a period of political stability, authoritarianism, and bureaucratic control. The political situation under Ayub Khan was probably a key determinant of the economic performance of the country, both positive and negative. When the Ayub Khan government was celebrating its ten years in office and calling it the 'Decade of Development', unrest in both West and East Pakistan was identifying the failure of the regime by the way it had contributed to income and regional disparities. Most observers have claimed that the overall assessment of the ten years of Ayub Khan must be mostly negative, and that this regime was more a failure than a success. Some have even called Ayub Khan's ten years the 'Controversial Sixties'. Unlike most analysts, we will argue that the Ayub Khan era was in fact highly progressive and dynamic, and that despite some negative consequences of its economic strategy, it was overall a resounding success.

The Zulfikar Ali Bhutto regime, which largely emerged out of the contradictions and conflicts under Ayub, was very different from the regimes of the past. Pakistan's circumstances were very different in December 1971 when Bhutto took over than they had been in the previous twenty-four years. A very clear break with the past was represented by the fact that the more populous eastern wing of the country had emerged as an independent nation. Criticism of the performance of the Bhutto regime has been particularly harsh and there is a general impression that this period was Pakistan's 'worst' period economically. However, here

as in the case of the Ayub Khan period, we re-examine the evidence and the issues, and reach somewhat different conclusions. We argue that, while some of Bhutto's economic policies may have had negative repercussions on the economy, the five-and-a-half-year period probably also had Pakistan's worst share of luck. The 'bad luck' factor between 1972 and 1977, when Zulfikar Ali Bhutto was in power, contributed significantly to the poor performance of the economy.

The period since 1977, from the fall of Zulfikar Ali Bhutto until the present, once again has a continuous theme, which is discussed separately in the next chapter. Just as a major break came about in the evolution and development of Pakistan in 1971, so the period from about 1977 to the early 1980s forms a different development pattern.

In this chapter, we take a look at the performance of Pakistan's economy, with particular emphasis on the industrial sector, in the period 1947–77. We examine data, look at events, and discuss policy issues that were important in determining the success and failure of that performance. Although there is some discussion of the role of the state and of political and institutional factors in determining economic strategy, policy, and outcomes, for the most part, we reserve our comments on the role of the state and political and institutional factors for a later chapter. In Chapter 19, we synthesize the crucial link between these apparently independent and unique factors—the state, institutions, classes, strategy—and examine economic development in a more realistic and holistic context, distant from the factual and largely empirical nature of this chapter.

6.1 1947–58: Exchange Rates, Trade Policies, and Import Substituting Industrialization[5]

Very soon after independence, the Pakistan government acknowledged the precarious nature of the base of Pakistan's economy and identified areas and strategies that would need to be given urgent consideration. In its Statement of Industrial Policy of April 1948, it stated:

> The most striking feature of Pakistan's present economy is the marked contrast between its vast natural resources and its extreme industrial backwardness. A country producing nearly 75 per cent of the world's production of jute does not possess a single jute mill. There is an annual production of over 15 lac [1.5 million] bales of good quality cotton, but very few textile mills to utilize it. There is an abundant production of hides and skins, wool, sugar cane, and tobacco—to name a few of the important products—but Pakistan's considerable resources in minerals, petroleum, and power remain as yet untapped. In laying down any policy of industrialization, note has to be taken of these deficiencies and handicaps, and a concerted effort made to overcome them.[6]

On the basis of this assessment, the government felt that Pakistan would need to

> seek, in the first place, to manufacture in its own territories, the products of its raw materials, in particular jute, cotton, hides, and skins, etc. for which there is an assured market whether at home or abroad. At the same time, to meet the requirements of the home market, efforts will be made to develop consumer-goods industries for which Pakistan is at present dependent on outside sources.[7]

The result of these objectives was that between 1949 and 1958 the growth rate of industry in Pakistan was amongst the most rapid for any country in the world. In united Pakistan, large-scale manufacturing grew at a phenomenal 23.6 per cent between 1949 and 1954, and afterwards, by the still very impressive 9.3 per cent up to 1960. The investment rate more than doubled during the 1950s, even though there was no increase in per capita income in that decade—in united Pakistan, GNP per capita grew on average by only 0.2 per cent between 1949 and 1954, and at zero per cent in the next five years.[8,9] In West Pakistan the growth rates were even more impressive, with large-scale manufacturing growing at 19.1 per cent between 1949 and 1958, and per capita income increasing by 6.97 per cent in the same period.[10] The main feature of the 1950s was the establishment and expansion of the large-scale manufacturing sector, which ranged from a high annual growth rate of 28.7 per cent in 1953/4 to a (still high) low of 4.9 per cent in 1957/8. Although starting from a non-existent base, and against all odds, Pakistan achieved very impressive rates of growth in its first decade (see Table 6.1).

With industry growing at high rates, there was a reverse picture in the agricultural sector, which only once in this period achieved double-digit growth rates. This is also the period when agriculture suffered negative growth rates in some years. Agriculture stagnated to the extent that its growth was not even enough to cope with the growth in population, resulting in a fall in per capita consumption of food grain and the need to import food as well.[11] In the mid-1950s, as much as 65 per cent of the civilian labour force was employed in agriculture and more than 75 per cent of the population lived in rural areas. Hence, a low growth rate in agriculture meant that the potential market for the growing manufacturing sector was also stagnant, restricting further growth in the manufacturing sector. Gustav Papanek has argued that 'agriculture was the sick man of economic development in Pakistan during the 1950s. A stagnant agriculture in a predominantly agricultural economy meant a slowly growing economy.'[12] As we will show, the policies that were adopted in this period had a marked anti-agricultural bias and the terms of trade between agriculture and industry were heavily biased against the former (see Table 6.2). In fact, Stephen R. Lewis argues that 'the major impact of economic policy in the 1950s was to transfer income away from agriculture and from urban consumers, and to the new and rapidly growing manufacturing sector'.[13] Let us now turn to some of the tools and mechanisms which influenced investment and economic development in the first decade.

Table 6.1
Annual Growth Rate 1950–58 at 1959/60 Factor Cost (% per annum)

Year[a]	Agriculture	Manufacturing		Wholesale and retail trade	Banking and insurance	Public administration and defence	Services	GDP
		Large scale	Small scale					
1950/1	2.6	23.5	2.3	6.1	9.1	2.5	4	3.9
1951/2	–9.1	18.7	2.4	0.5	10.0	4.0	4	–1.8
1952/3	0.2	23.6	2.2	0.6	7.6	–4.4	4	1.7
1953/4	13.6	28.7	2.3	6.3	8.5	–2.4	4	9.4
1954/5	–0.8	24.1	2.3	5.5	2.6	4.6	4	2.7
1955/6	2.1	17.5	2.3	2.3	21.5	1.6	4	3.4
1956/7	2.3	8.1	2.3	3.2	22.9	–2.6	4	3.0
1957/8	1.9	4.9	2.2	3.4	–1.7	–2.2	4	2.6
1950–1954 (ave.)	1.8	23.6	2.3	3.4	8.8	–0.1	4	3.3
1954–1958 (ave.)	1.4	13.6	2.3	3.6	11.3	0.4	4	2.9

[a]The annual growth rate for 1950/1 means the rate for the period 1949/50 to 1950/1.
Source: Government of Pakistan, *Pakistan Economic Survey 1984–85* (Islamabad, 1985).

Table 6.2
Domestic Terms of Trade for West Pakistan (Three-Year Moving Averages): 1951–64

Year	West Pakistan	
	Manufacturing sector	Agricultural sector
1951–1954	108.62	97.39
1952–1955	112.22	91.14
1953–1956	116.42	87.36
1954–1957	112.00	91.41
1955–1958	107.77	96.03
1956–1959	104.52	98.76
1957–1960	102.60	99.43
1958–1961	98.05	103.13
1959–1962	95.32	106.39
1960–1963	94.75	108.28
1961–1964	96.06	107.84

Source: Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen & Unwin Ltd, 1969), 60.

6.1.1 The Impact of the Exchange Rate

Before the partition of the subcontinent, the area constituting Pakistan was the bread-basket of India. The areas that became Pakistan were net importers of industrial goods from India and produced agricultural commodities, such as cotton, wheat, and jute. After independence, a customs union between India and Pakistan existed through the use of a common currency, but this was broken up in 1949. The same year also saw the Government of Pakistan taking one of its most important decisions, which had a vital impact on industrial development in the country.

In September 1949, the pound sterling was devalued, as were the currencies of numerous countries including that of India, Pakistan's main trading partner. Viqar Ahmed and Rashid Amjad argue that 'the reason why the Pakistan government did not devalue its own currency at that moment is one of the most controversial questions of the period and the genesis of the pro-industrial bias in government policy in many ways can be traced back to this decision'.[14] One reason why this decision was taken was to announce to the world that Pakistan was an independent country and did not mimic Indian economic policy. Other reasons were to continue to sell raw jute to India (since Pakistan had no jute mills) at a now higher price, and to be able to import machinery and capital goods at a cheaper price. However, India punished the newly-born Pakistan by suspending trade between the two countries and refusing to accept Pakistan's independent stand. The Pakistani government imposed some controls on imports and exports in order to manage trade with countries that had devalued, as their imports were now cheaper. By not devaluing, the interests of Pakistan's exportable raw materials remained protected.

Pakistan was a monopoly exporter of jute, mainly to India, and hence gambled on the presumption that by not devaluing it would reap additional profits from the higher price of jute. In 1948/9, India imported 55.8 per cent of Pakistan's exports, but all such exports were suspended in September 1949. The consequences of the Indian retaliation could have been quite catastrophic for Pakistan's economy: either Pakistan would have been forced to devalue, as was the motive for India's trade suspension, or Pakistan would need to hurriedly find alternative markets for its exports. Neither decision was easy. However, Pakistan's luck changed for the better, as it has done on so many occasions, with positive effects for the economy.

The Korean War broke out in June 1950, and there was a fear that it might trigger off World War Three. Countries began stockpiling and storing raw materials, and as demand for them increased, so did their price. Jute and cotton were both in heavy demand, and Pakistan was able to make spectacular profits on its exports. Not only that, but demand was worldwide—Pakistan's traditional markets, India and

Britain, now no longer reigned supreme as Pakistan was able to diversify into new areas. Import controls that had been imposed only a few months before were again liberalized after the Korean War began. India also recognized Pakistan's new exchange rate, and trade was resumed after a suspension of eighteen months, but on a smaller scale than earlier.[15] The decision not to devalue had paid off.

The Korean boom lasted from 1950 to 1952, but by mid-1951 world prices of raw materials began to decline and export earnings also saw a decrease. There were clear signs that the market was heading for a recession, but Pakistan was too slow to react, and policies continued as if nothing had changed. Since Pakistan's exchange rate was still high compared to its trading partners which had devalued in 1949, after the Korean boom in 1952 there were expectations of a devaluation. In 1952 jute and cotton prices fell, as did export earnings, and Pakistan was facing a serious balance of payments crisis and sharply falling reserves. As it did in 1949, the government decided not to devalue and instead imposed very strict exchange controls and a set of physical controls on imports and exports. As Lewis shows, 'tariffs were maintained, but they were not the major determinant of prices of import composition. Export taxes on jute and cotton were raised during the Korean war, and were lowered somewhat following the fall in prices. Exporters of such commodities received low rupee prices for their goods both because the currency was devalued and because of the export taxes'.[16] The probable reason for not devaluing in 1952 despite a deterioration in the balance of payments was that capital goods were now needed to start the process of industrialization and a devaluation would have raised their prices. Hence, the government resorted to the imposition of controls instead.

The decision not to devalue may, with hindsight, have been the critical decision that started Pakistan on the road to industrial and economic development. Since industry was non-existent in the earlier years, international trade was the main sector where large profits could have been made. The Korean War export boom resulted in traders and merchants amassing considerable amounts of wealth. Trading was much more profitable than industry during the Korean boom. Viqar Ahmed and Rashid Amjad make the pertinent point that 'the favourable conditions for the conversion of merchant capital into industrial capital were the result of another important economic event related to the Korean war: the collapsed prices of raw materials after the end of the war'.[17] With controls imposed on imports, especially on consumer goods, 'the prices of these goods increased sharply in the domestic market which changed the terms of trade in favour of industry and against agriculture. This led to a sharp increase in the profitability of the industrial sector, and in comparison with the other sectors including trading, industry now became the most attractive sector.'[18] Hence, traders with their amassed wealth converted merchant capital into industrial capital and so began the process of industrialization in Pakistan. Although one study has argued that it was 'practical exigencies rather than conscious policy [that] provided the initial diversion of investible resources towards industry',[19] Stephen Lewis makes the essential point that 'government policy was not neutral, however, but decidedly favoured industrialization, particularly the decision not to devalue'.[20] Moreover, Lewis argues that, once the import licensing scheme was under way, here too conscious decisions were taken about the direction that the process of industrialization should take (see following sections).

6.1.2 The Trade Policy Regime[21]

Once the industrialization process had begun after merchant capital moved into industry, and after the collapse of the Korean boom in 1952, when falling export prices caused the balance of payments position to deteriorate, controls and restrictions were imposed on trade, having a substantial impact on the ensuing industrialization process. As Lewis argues, 'from 1953–64 virtually all imports into Pakistan were regulated by some form of quantitative controls'.[22] The trade policy adopted by Pakistan 'had three major aspects: (i) overvaluation of the rupee relative to other countries, (ii) use of quantitative controls on imports to regulate the level and composition of imported goods, and (iii) a highly differentiated structure of tariffs on imports, and export taxes on the two principal agricultural exports: jute and cotton'.[23]

The government began to favour tariff protection as a means of promoting industrialization. It wanted a cascaded tariff structure, with lower tariffs on intermediate and capital goods, tight controls over the import of luxuries, controls on other consumer goods, and easier access to capital goods and industrial raw materials. Table 6.3 shows the cascading nature of tariffs imposed in the late 1950s. However, despite the high prevalence of tariffs, Lewis makes the point that 'while the tariff structure played some role in directing resources in Pakistan, *that role was a relatively minor one*. . . . The principal determinant of the structure of imports and the set of domestic relative prices was the import licensing system.'[24] Licensing was used explicitly as a protective or exchange-saving device.

In assessing the role of tariffs, compared to that of quantitative measures, Lewis's conclusions are clear:

> It is clear that tariffs and indirect taxes played relatively minor roles in directing resource allocation, even when compared with other policy variables. Direct quantitative controls were dominant in setting prices and incentives. Through their substantial impact on relative prices, these controls speeded the process of structural change both by imposing the inducements to invest in various industries and by transferring substantial amounts of income to industrialists who reinvested them in the profitable manufacturing sector. The *directions* that industrial growth took were probably the same as those that would have been taken in the absence of major policy decisions due to market size and domestic resource availabilities. The policies adopted increased the *speed* with which the transformation of industrial structure occurred, both by increasing incentives and by increasing incomes in the hands of the 'saving' sector of the economy.[25]

Table 6.3
Average Rate of Duty on Imported Goods by Types of Commodity: 1955–64

Description	1955/6	1956/7	1957/8	1958/9	1959/60	1960/1	1961/2	1962/3	1963/4
Consumption goods									
Essentials	35	35	35	35	35	55	55	55	56
Semi-luxuries	54	99	99	99	99	111	111	111	116
Luxuries	99	99	99	99	99	140	140	140	142
Raw material for consumption goods									
Unprocessed	26	26	26	26	26	27	27	27	30
Processed	43	43	43	43	43	50	50	48	51
Raw material for capital goods									
Unprocessed	23	23	23	23	23	28	28	28	31
Processed	38	38	38	38	38	40	40	39	42
Capital goods									
Consumer durables	71	71	71	71	81	85	85	85	89
Machinery and equipment	14	14	14	14	14	17	17	17	17

Source: Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen & Unwin Ltd, 1969), 72.

6.1.3 The Consequences of Exchange Rate and Trade Policy for Industrialization

The consequences of the exchange rate and trade policies adopted by Pakistan should be fairly clear. Box 6.1 describes how such policies lead to a particular type of import substituting industrialization. The type of protective policy pursued in Pakistan can be put simply as follows: '(i) produce anything that can be reasonably produced domestically; (ii) once production has started domestically, ban imports of competing goods so as to save foreign exchange'.[26] More specifically,

> If the average tariffs were any guide to the differential incentive structure during the early years of industrialization, the very high incentives for domestic production were given to those items for which the domestic market was the

Box 6.1

How Import Substituting Industrialization (ISI) Works

The economic strategy that was in vogue in the 1950s and 1960s was import substituting industrialization. Stephen R. Lewis explains how it worked:

> A country beginning with virtually no productive capacity in manufacturing, and facing present or potential balance of payments problems, will be tempted to follow a policy of placing restrictions on the imports of non-essential goods, usually consumer goods, for two reasons. First, given the scarcity of foreign exchange, it feels that essential needs of established industries, or potential industries, should have priority. Second, there is some appeal to the idea that restricting the flow of imported consumer goods will release more resources for saving, since consumption would be restricted by lack of physical availability. The difficulty with this approach, as has been noted by numerous writers, is that it encourages the domestic production of consumer goods only, and it does so both because there is a relatively protected market for consumer goods and there is a relatively cheap source of imported capital goods and raw materials on which to base the production of the consumer goods. Industries are established which have heavy dependence on imported supplies, and there is little incentive to develop local capital goods and intermediate goods industries to serve them. In addition, since this sort of policy is usually a concomitant of maintaining an overvalued currency, the export of the newly produced consumer-oriented goods is discouraged; domestic resources are valued more highly in saving than in earning foreign exchange. As a result, after the process has gone on for some time, the country finds itself with productive capacity heavily dependent on imported sources of supply and with no new means of earning foreign exchange.

Source: Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen & Unwin Ltd, 1969), 38–9.

> smallest: luxury consumer goods and consumer durables. Imports of these goods were most heavily penalized, primarily as a measure to save foreign exchange. Essential and semi-luxury (or semi-essential) consumer goods, which included most of the basic mass-consumption items (food, cloth, kerosene, matches, soap, etc.) received more protection than raw materials for production of such goods. Only since 1959/60, after the first rush of industrialization was over, were the differential incentives given to broad-based consumption goods (particularly semi-luxuries) widened sharply. It is true throughout, however, that producer durables had low tariffs, and, if the classification system is right, the duties on raw materials for producer durables exceeded the duties on the goods themselves.[27]

Import substitution progressed easily and very rapidly in those industries that had the highest protection, i.e. consumption goods, and those that had cheap and ready access to domestically produced, primarily agricultural, raw materials, such as cotton, jute, and leather. Another reason why consumer goods grew is provided by Lewis. He argues that 'the size of the domestic market at Partition and well into the 1950s was decidedly larger for consumer goods than for most intermediate and investment related goods'.[28] These were also those industries in which Indian imports made a significant contribution to Pakistan's domestic market.

There is a tendency for some observers to suggest that much of what happened in the industrial and economic sphere in Pakistan in the 1950s was erratic and not thought through. However, as we have shown above, even the decision not to devalue seems to have had a clear logic behind it, although good luck did endorse that decision further. Similarly, the import licensing scheme also seemed to be a thought-out policy measure which affected relative prices and hence patterns of industrialization. The pattern of investment and import substitution influenced the decisions of the licensing authorities about what sorts of imports and, hence, what sort of industrial development should take place. Lewis agrees that the 'licensing system was largely a mirror of the decisions to invest in different industries'.[29]

6.1.4 The End Result

Since almost all capital goods and most non-agricultural industrial goods were imported, the state played a major role in determining the nature and structure of industry through the licensing system and tariff structure, and through the incentives it provided. Stephen Lewis summarizes the impact of these measures on trade as follows:

> The exceedingly rapid growth of modern manufacturing during the 1950s, amid a relatively stagnant economy, particularly in agriculture, was reflected in the decline of imports of some manufactured goods, the rise of those imports related to investment activity, the emergence of certain manufactured exports, the conversion from an export surplus to an import surplus in food grains, and the decline of agricultural exports that were used as raw materials by domestic industries. In the 1960s the changes in the structure of production were somewhat smaller, and in different directions due to the increased flows of aid-financed imports and the more rapid growth of such sectors as agriculture.[30]

The significant increase in exports was from the newly established manufacturing industries, mainly jute and cotton textiles, which replaced competing imports by the mid-1950s. Towards the end of the 1950s, Pakistan was in a position to produce export surpluses as well. In many ways, these results indicate the success of the first phase of the import substituting industrialization policy of the 1950s, where the emphasis was on consumer goods rather than on intermediate or capital goods. This strategy also rested on the government's preference for investment in those areas where foreign exchange could be saved regardless of cost, and its 'desire to produce domestically almost anything that technologically could be produced there'.[31]

Stephen R. Lewis estimates that the success of the import substituting strategy can be gauged by the fact that almost all the growth that took place in manufacturing between 1951 and 1955, and hence in overall growth, was due to import substitution. The increase in domestic demand was not a cause of growth up to 1954/5 and was only of consequence after 1960. The complete dominance of import substitution in the first half of the decade was reduced a little in the second half, but still accounted for over 20 per cent of growth of manufacturing output, with the newly established manufactured exports responsible for about 25 per cent.[32] Moreover, the trend in the first phase of import substituting industrialization was also showing a shift, as consumer goods industries, which accounted for about 70 per cent of manufacturing value added in 1954/5, contributed less than half of the growth after that period (Table 6.4).

While Pakistan's impressive growth rate in the 1950s was due to the fact that the country started with a low base in the first place, the other important factor was that, due to the restrictive measures enforced on the economy, profit rates in industry were very high. The government had very openly encouraged private sector initiative in economic growth, an encouragement to which the private sector responded enthusiastically. The annual returns on investment ranged from 50 to 100 per cent in the early 1950s, but dropped to between 20 and 50 per cent in the latter part of the decade. There were strong economic incentives to becoming an industrial entrepreneur, but Papanek notes that while 'high profits were strongly conducive to industrial investment . . . perhaps even more important were the strong disincentives to alternative activities. With the end of the Korean boom, international trade, and especially importing, suddenly became unattractive',[33] and therefore industrial development became a natural choice. Thus it was the lure of extraordinary profits and a lack of good alternatives that induced the process of industrialization.

The pattern of industrial development resulted 'inevitably', as Papanek argues, in a high degree of concentration. Most of the nascent industrialists were traders who had made

Table 6.4
Sources of Growth in Manufacturing Value Added: 1951–64 (% Distribution in Three Periods)

Percentage of total growth due to:	Domestic demand (1)	Export growth (2)	Import substitution (3)	Value added coefficient (4)	Total change (5)	Annual rate of growth of value added (6)
1951/2–1954/5						
Consumptions goods	-6.2	0.2	85.0	–	78.9	43.0
Intermediate goods	0.8	0.7	12.6	–	14.1	28.0
Investment and related goods	0.1	0.0	6.8	–	7.0	16.8
All industries	-5.3	0.9	104.4	–	100.0	38.8
1954/5–1959/60						
Consumptions goods	31.2	10.8	16.5	-5.8	52.6	15.6
Intermediate goods	8.7	15.3	2.2	0.5	26.7	27.0
Investment and related goods	12.5	0.2	5.6	2.4	20.7	28.0
All industries	52.4	26.3	24.3	-2.9	100.0	38.8
1959/60–1963/4						
Consumptions goods	45.1	–	-1.1	3.4	47.4	12.8
Intermediate goods	10.8	6.1	6.0	-3.7	19.2	13.7
Investment and related goods	30.6	0.4	-2.7	5.2	33.5	26.0
All industries	86.5	6.5	2.2	4.9	100.1	38.8

Source: Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen & Unwin Ltd, 1969), 49.

money in the Korean boom and were already well established and well-off. However, they had better possibilities for making more money and amassing further wealth given the high-profit, near-monopoly markets that were developing. Papanek shows that in 1950 there were 3,000 individual firms in Pakistan, but the concentration of wealth was so high that only seven individuals, families, or foreign corporations constituted 25 per cent of all private industrial assets in united Pakistan. Twenty-four units constituted nearly 50 per cent of all private industrial assets.[34]

While the development of the economy and of industry was private sector oriented, the institutions of the state did play an important role too. In the field of credit, the government was particularly significant. The Pakistan Industrial Credit and Investment Corporation (PICIC) and the Pakistan Industrial Finance Corporation (PIFCO) provided funds to the larger, more established firms which had adequate security and a high profit rate. PICIC provided nearly 'half of all its loans to a tiny group of leading industrialists'.[35] However, the role of both institutions was more important after the 1960s, and the links they made with industry show how the network of industry and finance in the private and public sector interacted (these issues are discussed in Chapter 19). The institution that played a more important role at this time was the Pakistan Industrial Development Corporation (PIDC), which 'pioneered in industries and areas which were neglected by private investors during the early period of industrialization'[36] and 'fulfilled an extremely useful function in supplementing private enterprise'.[37]

Although East Pakistan seceded from united Pakistan in 1971, the seeds for this process were sown long before. While Ayub Khan's decade is held responsible for fostering the economic decay and underdevelopment of East Pakistan, leading to the formation of Bangladesh, this is only part of the picture. In fact, it would be very unfair to hold the policies of Ayub's regime solely responsible for Pakistan's break-up, as many observers do. Even in the 1950s, strong biases in economic development had emerged, which were blatantly tilted against the eastern wing. For example, state institutions in the 1950s, such as PICIC and PIFCO, concentrated on industries in West Pakistan, while in 1958 about 66 per cent of the government's investment through PIDC was based in West Pakistan, which also received 62 per cent of foreign loans compared to the eastern wing's 38 per cent[38]. The cessation of trade between India and Pakistan in 1949 also had greater negative consequences for East Pakistan, as about 50 per cent of West Pakistan's trade and 80 per cent of East Pakistan's was with India. Table 6.5 shows that, in fact, West Pakistan had a continuous deficit in trade throughout the 1950s, while East Pakistan had a consistent surplus. The overall trade figures for united Pakistan were in surplus due to East Pakistan's contribution, mainly by exporting jute. This evidence shows very clearly that East Pakistan was instrumental in supporting the process of industrialization in (West) Pakistan. West Pakistan's development was built on a transfer of resources from the eastern wing, which got very little in return, and this process was initiated as early as the late 1940s and early 1950s.

Table 6.5
Balance of Payments of Trade: 1949–58

Balance of payments of trade (Rs. m)	1949/50 to 1950/1	1950/1 to 1951/2	1951/2 to 1952/3	1952/3 to 1953/4	1953/4 to 1954/5	1954/5 to 1955/6	1955/6 to 1956/7	1956/7 1957/8
East Pakistan								
Exports	683	1,211	1,087	643	645	732	1,042	910
Imports	372	453	764	367	294	320	360	819
Balance of payments	311	758	323	276	351	412	682	91
West Pakistan								
Exports	535	1,343	922	867	641	491	742	698
Imports	912	1,167	1,473	1,017	824	783	965	1,516
Balance of payments	–377	176	–551	–150	–183	–292	–223	–818
Pakistan								
Exports	1,218	2,554	2,009	1,510	1,286	1,223	1,784	1,608
Imports	1,284	1,620	2,237	1,384	1,118	1,103	1,325	2,335
Balance of payments	–66	934	–228	126	168	120	459	–727

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 65.

Just as East Pakistan was neglected, so was the agricultural sector: Table 6.2 shows how the terms of trade developed against agriculture and in favour of industry in the 1950s. Viqar Ahmed and Rashid Amjad write that 'the initial accumulation of industrial capital had taken place as a result of the large tribute paid by the agricultural sector to the industrial sector and by the urban consumers. The former had supplied agricultural raw materials at cheap prices and had paid high prices for manufactured consumer goods in return'.[39] The devaluation in 1955 was meant to redress the balance against agricultural exports and occurred simultaneously with a shift in giving some priority to agriculture.

Despite some negative consequences of the economic policies pursued by the governments in Pakistan in the first decade, it would be fair to say that they initiated an era of industrial growth and development which laid the foundation for the Decade of Development between 1958 and 1968. On the basis of the criteria that were considered important at that time—in the 1950s, when import substituting industrialization was the received wisdom—Pakistan did very well for itself. Much of the criticism made of those policies forty years later (see Chapter 8) is quite unwarranted.

6.2 1958–68: The Decade of Development

There is little disagreement over the fact that the growth rates in agriculture, large-scale manufacturing and GDP showed astonishing trends over the ten years between 1958 and 1968. The disagreements exist over the nature and consequences of those growth rates and over an interpretation of the economic policies that formed what the government of the time called the 'Decade of Development' and what its critics have very mildly termed the 'Controversial Sixties'.[40] Viqar Ahmed and Rashid Amjad argue that

> this period of rapid economic growth, achieved mainly as a result of the policies pursued, generated a great deal of economic tensions. . . . Increasing disparities in regional income between the provinces, a concentration of industrial economic power, the failure of real wages to increase significantly, and a general belief of increasing income inequality, all contributed to the rejection of the Ayubian growth philosophy and strategy.[41]

We will examine the nature of these developments in the course of this section after looking at the facts regarding growth rates, the policies pursued and the consequences of those policies.

The impressive performance of the main sectors of the economy can best be gauged from Table 6.6. The high growth rates in large-scale manufacturing continued in the first few years of the Ayub regime with the average for the period 1960–5 rising to a phenomenal 16.9 per cent. Even after 1965, when there was a marked slowdown, growth rates in manufacturing still remained above to 10 per cent. In industry, it seems that the previous trends maintained during the 1950s continued well into the 1960s. Agriculture presents a marked improvement in the 1960s compared with the dismal situation in the 1950s. The reasons for this growth were the recognition in the late 1950s that the excessive pro-industrial bias was affecting agriculture very negatively and that a redress was necessary. Some steps were taken, but it was the Green Revolution (see Chapter 3) that was responsible for the very high growth rates of the late 1960s. For Papanek, 'the spurt in agricultural production was the main difference between the Pakistan of the 1950s and of the 1960s, as well as between Pakistan and other countries'.[42]

Table 6.6
Annual Growth Rate 1958–70 at 1959/60 Factor Cost (% per annum)

Year[a]	Agriculture	Manufacturing		Wholesale and insurance	Banking and insurance	Public administration and defence	Services	GDP
		Larges scale	Small scale					
1958/9	4.0	5.6	2.3	2.5	12.9	9.8	4.0	5.5
1959/60	0.3	2.7	2.3	5.9	22.1	–2.7	3.8	0.9
1960/1	–0.2	20.3	2.9	6.9	10.0	1.3	4.7	4.9
1961/2	6.2	19.9	2.9	7.8	8.5	3.9	4.0	6.0
1962/3	5.2	15.7	2.9	9.8	11.5	2.8	4.2	7.2
1963/4	2.5	15.5	2.9	10.1	8.9	9.7	4.0	6.5
1964/5	5.2	13.0	2.9	7.9	37.9	17.8	7.0	9.4
1965/6	0.5	10.8	2.9	8.7	10.9	56.5	1.1	7.6
1966/7	5.5	6.7	2.9	5.3	12.7	–14.4	4.3	3.1
1967/8	11.7	7.6	2.9	3.7	11.8	–2.5	4.0	6.8
1968/9	4.5	10.6	2.9	7.1	8.5	5.0	3.9	6.5
1969/70	9.5	13.9	3.0	10.9	19.4	3.6	6.8	9.8
1958–1964 (ave.)	3.0	13.3	2.7	7.2	12.3	4.1	4.1	5.2
1965–1970 (ave.)	6.2	10.4	2.9	7.2	16.9	11.0	4.5	7.2

[a]The annual growth rate for 1958/9 means the rate for the period 1957/8 to 1958/9.
Source: Government of Pakistan, *Pakistan Economic Survey 1984–85* (Islamabad, 1985).

In the first half of the 1960s, overall investment had risen to over 18 per cent of the GNP, and savings had doubled between 1949 and 1965.

6.2.1 Trade Policy Directing Industrialization

Although there was a great deal of continuity between the 1950s and 1960s, hence the similar levels of growth and development, some critical steps were taken, especially in the trade and exchange rate policies that were the prime movers of the 1950s. The new regime of Ayub Khan disbanded many of the controls that had been imposed following the post-Korean War recession in 1952. In 1959 there was a fundamental reordering and change in the method of directing industrialization through trade policy, and a series of liberal policies were introduced which remained in effect till 1965.

The main emphasis of the new trade policy in 1959 shifted away from direct controls and towards indirect controls on imports and on domestic prices of other goods. As Lewis shows, 'a number of measures were taken in import licensing that made market forces more important in determining the commodity composition of imports and the distribution of ownerships of import licences'.[43] It was the Export Bonus Scheme (EBS) or the Bonus Voucher Scheme, launched in 1959, that was considered to be the key to the import liberalization process in Pakistan (see Box 6.2 for how the scheme worked). The scheme allowed a free market in the bonus vouchers for certain commodities. In addition, the earlier closed and selective import licensing scheme of the 1950s, which was based on the importer's ability to import during the Korean boom of 1950–2, was replaced in 1961 by the Open General Licence (OGL), which allowed newcomers to enter the trading sector. A large amount of foreign exchange was allocated to the OGL, and given the buoyant nature of trade and of the economy, the new traders made substantial profits and gains from possessing import licences. The most 'market friendly' change was the introduction of the 'Free List', which permitted the import of certain goods without any licence. The Free List was extended over time from four items to fifty in 1964. The tariff structure continued to be used as a signalling device, as it had been in the 1950s, but as Table 6.3 shows, the differentials in the tariff rate structure widened, with the rates for consumer goods rising much more than for other goods. The bias against producing machinery and equipment locally continued, as the import duty on these items was still the lowest, thus making it easier to import these goods rather than produce them at home.

The main reason why the government could be so generous in its import policy in the first half of the 1960s was critically linked to the availability of foreign aid, which increased from 2.5 per cent of GNP in the mid-1950s to 7 per cent of GNP in the mid-1960s.[44] In fact, according to an important Asian Development Bank study, the 'import liberalization which took place during the first half of the 1960s *would have been impossible without this large increase in aid*',[45] In 1965 the Free List suffered serious setbacks as foreign aid was curtailed, and due to the resulting foreign exchange squeeze, the import liberalization policies were abandoned and many new import controls were introduced. (See section 6.2.2 for more on the contribution of foreign aid in the 1960s.) As long as foreign exchange resources were available, largely through aid, the government was eager to follow a liberal import regime.

Box 6.2

The Bonus Voucher Scheme

One of the most controversial instruments adopted by Pakistan's managers of the economy was the Bonus Voucher or Export Bonus Scheme. Some writers have argued that this scheme was responsible for Pakistan going on the wrong industrialization track, while others believe that the scheme was largely responsible for Pakistan's high growth. This box explains how it worked.

> The Export Bonus Scheme which was introduced in 1959 was a flexible and fascinating device which was used both to subsidize exports and to allow a safety valve on imports, while maintaining the basic structure of import controls on the vast majority of imports and while maintaining at the same time the official exchange rate at its existing level. Under the Export Bonus Scheme, an exporter received, in addition to the amount of rupees converted at the official exchange rate, Bonus Vouchers equivalent to some percentage of his export earnings (the percentage varied from time to time and from commodity to commodity). The Bonus Voucher could be used to import any item from a list of importables that changed from time to time. At some times during the last decade, goods on the Bonus Voucher importable list overlapped with goods importable under other types of licence, and sometimes there was no overlap. The exporter could import items himself, or he could sell the Bonus Vouchers in an organized market, at which the Bonus Vouchers have sold at a consistent premium above their face value. In most years of the Scheme the premium on Bonus Vouchers has been stabilized at around 150 per cent of face value, the stabilization having been accomplished by additions to and subtractions from the list of importables and the list of exports eligible for Bonus Vouchers or the rate at which Bonus Vouchers were awarded for those exports.
>
> An example may be helpful at this point. An exporter sells \$100 worth of Pakistani goods abroad, the Bonus rate on the goods being 20 per cent, and the premium on Bonus Vouchers 150 per cent. The exporter receives Rs. 475 from the State Bank of Pakistan, as well as Bonus Vouchers with a face value of Rs. 95. The exporter then sells the Bonus Vouchers in the market for Rs. 142.50, which gives him total receipts for his exports of Rs. 617.50, or 30 per cent more than the official exchange rate. The rate of subsidy is easily computed on any item, since it is the rate at which Bonus Vouchers are awarded *times* the premium at which Bonus Vouchers are selling. For some items the extent of subsidy has reached 60 per cent of the f.o.b. value of exports. Bonus Vouchers were awarded to almost all manufacturing industries and to some non-traditional primary products such as fine rice and fish.
>
> On the import side, Bonus Vouchers acted as import licences, and at times when Bonus Vouchers sold at 150 per cent of face value, the cost of foreign exchange to importers was 150 per cent above, or two-and-a-half times, the official exchange rate. Tariffs and sales taxes on imports were added to the cost to importers, but were computed at the official exchange rate, not the Bonus Voucher exchange rate. The advantage of Bonus Vouchers from the point of view of importers was that it was possible to import items immediately, and the waiting period until the next shipping period was announced in accordance with the regular licensing system could be by-passed through the use of Bonus Vouchers. Thus, the Bonus Voucher system provided an excellent safety valve for those firms who might have run short of a critical spare part or raw material during a licensing period. A number of items of machinery and transport equipment were also imported under Bonus Vouchers, so that the initial fears, which were that Bonus Vouchers would simply provide more luxury consumption goods, did not materialize to the extent that many people had expected at the time of the introduction of the scheme.

Source: Lewis, Stephen, *Pakistan: Industrialization and Trade Policies* (London: George Allen and Unwin, 1970), 28–30.

The government's import licensing scheme was supposed to encourage the private sector to invest, just as the EBS was a means for exporters to acquire additional foreign exchange by exporting more. The exchange rate had been overvalued in the 1950s (and later as well), but the EBS compensated for that and boosted exports, especially of manufactured goods. The scheme transferred a subsidy to exports, and the exports of raw jute fell from 60 per cent of total exports in 1958 to 20 per cent in 1968/9, while the exports of cotton and jute textiles increased from 8.3 to 35 per cent in this period, and the exports of other manufactures increased ten-fold from 2 to 20 per cent. The EBS also had a positive impact on imports, making raw materials and machinery imports easier and cheaper. The Export Bonus Scheme was considered to be an innovative device helping both import substituting and export growth.[46] In 1965 Pakistan's manufactured exports were greater than the *combined* manufactured exports of South Korea, Turkey, Thailand, and Indonesia.[47] The main feature of the foreign exchange regime in the 1960s was that, with an overvalued exchange rate, it became cheaper to import industrial machinery, which resulted in low prices for agricultural inputs, while the EBS transferred subsidies to manufactured exports.

The impact of the EBS and the import licensing and liberalization strategy on industrial development was considered to be 'dramatic' by some observers. The Asian Development Bank study shows that large-scale manufacturing growth increased from 8 per cent per annum between 1955 and 1960, to 17 per cent between 1960 and 1965 in the Second Five-Year Plan. The controls reimposed following the foreign exchange and aid curtailment caused this growth to fall to about 10 per cent in the second half of the 1960s.[48]

An interesting outcome of these trade policies, as Stephen Lewis shows, is that in sharp contrast to the 1950s *none* of the growth in industry during the period of the Second

Five-Year Plan was due to import substitution—a remarkable transformation, indeed.[49] Instead, domestic demand and absorption were the dominant factors. As foreign aid had increased, so had imports, and even though manufacturing output grew at impressive rates due to the import policies and foreign resources, imports increased at a faster pace. Both industrial production and investment responded well to the liberalization of imports. The nature of import substituting industrialization had also changed over the years, shifting away from almost wholly the consumer goods industry to intermediate and capital goods. Table 6.7 shows the differences in the three sectors in the 1960s, and also shows that the growth rate was much higher in the first half of the decade than in the second half. The most interesting observation that can be made from Table 6.7 is that the growth in investment goods was by far the fastest of all sectors during the early 1960s. The reason, according to the Asian Bank, was that since this sector was most dependent on imported raw materials, it benefitted the most from import liberalization.[50] Another reason why import substitution slowed down was the EBS, which encouraged the export of manufactured goods. The share of exports in total consumer goods output rose from 15 per cent in 1959/60 to 45 per cent in 1969/70.[51] Meekal Ahmad evaluates the impact of the EBS on exports and argues that it 'compensated for the overvaluation of the domestic currency by introducing a series of multiple exchange rates depreciated in relation to the official exchange rate so that the profitability of exporting was brought more in line with the incentives for sales in the domestic market'.[52]

Asad Sayeed goes beyond looking at growth rates of industrial performance, as he feels these often hide the costs incurred in the process. Instead, he argues that 'productivity growth rates, especially total factor productivity growth (TFPG), is one measure which reveals the efficiency of factor use'[53] (see Box 6.3 for how to calculate TFPG). The growth rates in total factor productivity shown in Tables 6.8 and 6.9 reveal that Pakistan's growth rate of 5.06 per cent was far higher than many comparable countries, indicating 'both technological dynamism and dynamic allocative efficiency in a comparative perspective'.[54] This evidence only underlines the fact that growth in manufacturing was higher than in most other countries in the 1960s, and was highly efficient, as it came about due to improvements in the amount of output per unit input (see Box 6.3).

6.2.2 Foreign Aid, the Private Sector, and Inequalities

Gustav Papanek writes that 'foreign aid contributed *significantly* to Pakistan's growth, from the late 1950s; *without it, the rapid increase in development in the 1960s could not have been possible*'.[55] Keith Griffin felt that in the mid-1960s 'the entire social and economic system that had been built up, was heavily supported by and sustained through foreign assistance'.[56] Rashid Amjad argues that the 'explanation for the boom in private industrial investment in the first half of the sixties and its subsequent slowing down lies principally in the change in foreign aid inflows to the industrial sector

Box 6.3

How can Productivity Growth be Measured?

What is the Engine of Growth? Is it Education, Technological Improvement or Hard Work? Some answers:

> Asia's growth performance has been so spectacular and so sustained that it has been dubbed the East Asian Miracle in a study by no less an authority than the World Bank. But as miracles have true believers, so too must they have debunkers. To challenge the received wisdom that Asia has a magic formula for success, we have Prof. Paul Krugman of Stanford University, who states flatly that the miracle is based on 'perspiration rather than inspiration'. Krugman's argument, in which he relies heavily on empirical work by Prof. Alwyn Young of MIT and others, is very simple. He says that Asian growth has been driven by growth in inputs like labour and capital rather than by gains in efficiency. In this sense, East Asia is no different from other economies at similar stages in their development, like the Soviet Union in the 1960s and 1970s. Hence, the miracle is no miracle at all.

Introducing 'Growth Accounting'

Krugman makes his case by using a basic equation of 'growth accounting'. This is a technique which uses regression analysis to isolate and quantify contributions to economic growth. The equation is as follows:

GDP growth = growth in labour input + growth in capital input + total factor productivity (TFP)

The rationale behind this is simple. Economic growth comes about either through the application of more inputs or through a rise in output per unit input, i.e. improvements in TFP. The labour input variable captures all the influences that increase either the quantity or quality of labour used in the production process. These include growth in population, rising participation rates, growth in employment and improving levels of education and skills. The capital input variable reflects changes in the stock of physical capital used in production and is measured by spending on plant, machinery, equipment, roads, telecommunications, and so on. What is left is TFP which is a pure measure of efficiency, i.e. improvements in the amount of output per unit input. This comes from improvements in management and work organization and improvements and innovations in technology. Since it is very difficult to measure TFP directly, empirically it is derived as a residual in the growth equation. TFP is what is left after the contributions of labour and capital are determined and subtracted out.

Source: Jardine Fleming Securities Limited, 'Asian Economic Outlook', Hong Kong, 1996, 18.

Table 6.7
Rate of Growth of Manufacturing Output: 1960–70 (% per annum)

Industries	1960–1965	1965–1970	1960–1970
Total manufacturing	16.0	10.0	12.0
Consumer goods	10.6	9.0	10.0
Food	9.2	11.3	11.0
Beverages	16.5	6.1	11.0
Tobacco	17.3	10.4	15.0
Textile	5.9	8.7	7.0
Footwear	8.1	4.6	6.0
Woodwork	12.7	5.4	9.0
Furniture	17.0	4.0	11.0
Printing	9.4	8.1	9.0
Miscellaneous	19.3	7.0	13.0
Intermediate goods	12.0	8.0	9.0
Paper	7.2	11.2	8.0
Leather	15.7	9.6	12.0
Rubber	17.2	8.5	13.0
Chemicals	20.3	15.9	18.0
Petroleum	49.3	7.4	27.0
Investment goods	20.0	8.0	13.0
Non-metals	11.5	8.0	9.0
Basic metals	12.0	9.8	10.0
Metal products	21.8	7.0	14.0
Machinery	23.4	7.0	15.0
Electrical machinery	24.8	5.7	16.0
Transport equipment	26.9	7.5	19.0

Source: Ahmed, Meekal, in Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 54.

Table 6.8
Growth Rate of Total Factor Productivity: 1960–70

Industries	TFPG
Food processing	2.17
Tobacco manufacturing	8.19
Textile manufacturing	5.27
Footwear and wearing apparel	1.30
Paper and paper products	–8.71
Printing and publishing	5.68
Leather and leather products	9.60
Rubber and rubber products	12.64
Chemicals and chemical products	–2.31
Non-metallic minerals	–2.83
Basic metal industries	8.13
Metal products	1.52
Non-electrical machinery	2.81
Electrical machinery	5.65
Transport equipment	0.90
Miscellaneous	10.95
Total	5.06

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 56.

in the sixties'.[57] In fact, he goes even further and says that

> the entire economic system which operated in Pakistan in the sixties was quite different from that suggested by earlier writers. It bore little resemblance to classical nineteenth-century capitalism (portrayed by writers like Papanek). On the other hand, the system did not fail because the capitalist class were no longer prepared to 'play the game' or had lost the desire to invest (as, for example, Nulty would make us believe). The system which operated in Pakistan came very close to being what we can term a 'Foreign Aid Dependent Regime' in which the mechanics of industrial growth were in one way or another made dependent on foreign aid inflows. Once these aid flows slowed down, the system, not being able to replace foreign aid with other forms of external finance like direct foreign investment, and without the peculiar boost to profitability associated with the local system for dispensing aid, found it difficult to sustain the earlier growth it had generated.[58]

These extracts and the discussion in the earlier sections show that Pakistan's growth in the 1960s, and the policies pursued (import liberalization, for example), were contingent upon the country receiving a substantial amount of foreign aid. Once the aid stopped, so did growth in the economy. And while foreign inflows mattered, the (unwritten) conditions to the aid made the role of the private sector paramount. Papanek, a firm believer in the leading role of capitalism and the private sector, argues that 'for ideological reasons, the United States, Germany, the World Bank, and others have been strong advocates of private enterprise. A country that caters to this preference is bound to profit.'[59] He considers Pakistan's industrial experience from the 1950s to the mid-1960s to be a success story of private enterprise, but the incentives that foreign aid generated were critical. Rashid Amjad argues that 'foreign aid played a crucial role in the creation of . . . favourable conditions and had a direct impact on the private sector'.[60] Thus, foreign aid in association with the private sector was the main instrument in Pakistan's economic growth in the 1960s. Interestingly enough, there was also an explanation of the economic development model of the 1960s which not only rested its premise on the leading role of the private sector, but also justified increasing inequalities. This was the Doctrine of Functional Inequality.

Ali Cheema explains the concept of Functional Inequality rather eloquently. He says that

Table 6.9
Total Factor Productivity in Manufacturing: Selected Countries

Country	Period	TFPG
Argentina	1960–1970	2.64
Brazil	1960–1970	0.75
Chile	1960–1970	0.33
Colombia	1960–1970	3.46
India	1959–1976	0.00
Korea	1960–1973	8.30
Mexico	1960–1970	3.01
Thailand	1963–1977	1.50
Turkey	1963–1976	1.50
Venezuela	1960–1970	1.92

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 56.

> this philosophy was part of Ayub Khan's Martial Law government's policy, and was the central pillar of the advice given to the Pakistan government by the Harvard Advisory Group. In simple terms the doctrine suggested that resources should be directed towards the industrial sector which has a higher propensity to save, and that agriculture and wages should bear the brunt of this transfer. The idea was that profits in the industrial sector should be raised giving the push towards growth which will result in automatically positive distributional consequences as development proceeds.[61]

Essentially this doctrine propagated the pursuit of what Papanek calls 'the social utility of greed'. The outcome was the concentration of wealth and income in the industrial sector (see Box 6.4).

Rashid Amjad's excellent work on private industrial investment in Pakistan documents and highlights the extent of that concentration. A dominant small group of monopoly houses had begun to emerge in the 1950s in the industrial sector, a trend which was accentuated in the 1960s. In 1970 there were 44 monopoly houses, which controlled about 77 per cent of gross fixed assets of all manufacturing companies listed on the Karachi Stock Exchange. These firms controlled about 35 per cent of all assets of the entire large-scale manufacturing sector and at the same time had close links with the financial sector. Seven of the seventeen Pakistani banks were under the direct control of the monopoly houses, accounting for 60 per cent of total deposits and 50 per cent of loans and advances. They had an extended network of interlocking directorates, where the board of directors of one company sat on the board of directors of others. Moreover, there were strong links between private industry and government financial institutions: between 1958 and 1970, 65 per cent of total loans disbursed by PICIC went to thirty-seven monopoly houses, with the largest thirteen of these accounting for about 70 per cent of these loans. Dr Mahbub ul Haq, a key supporter and architect of the Ayub government's Doctrine of Functional Inequality, revealed figures, as the Ayub regime was falling, of even greater concentration: he claimed that (the famous) twenty-two families controlled 66 per cent of industrial assets, 70 per cent of insurance, and 80 per cent of total banking assets. Rashid Amjad argues that while this claim was never substantiated, it nevertheless had a great deal of truth in it, and his own research does show very high concentration.[62]

While there was certainly economic concentration at one end of the wealth spectrum, there was also a general belief that income inequalities had increased during the 1960s and that there was no substantial increase in the level of real wages. The labour movement of 1968/9 was a major factor in the fall of Ayub Khan's regime, as it was fuelled by the perception that the fruits of growth had not trickled down to sections of society other than the industrialists. The strategy of Functional Inequality also gave low priority to the

Box 6.4

The Social Utility of Greed

Gustav Papanek argues that inequality leads to economic growth. He writes as follows:

> The problem of inequality exists, but its importance must be put in perspective. First of all, the inequalities in income contribute to the growth of the economy, which makes possible a real improvement for the lower-income groups. The concentration of income in industry facilitates the high savings which finance development. Allowing the more enterprising and wealthy peasants to sink tube wells is a major factor in expanding agricultural output. In turn, growth of the economy means cheaper cloth, cheaper food, and more adequate supplies for the bulk of the population. Great inequalities were necessary in order to create industry and industrialists; but to maintain industrial growth after the first 5 to 10 years does not require the same high rate of profit and therefore does not imply the same inequities. Greater equality during the early period at the cost of growth would probably have left the poorer groups in a worse position absolutely, though they would have been better off relatively. This argument holds true, however, only because inequalities in income result substantially in inequalities in savings, not in consumption. High incomes are more acceptable, politically and morally, because they are used chiefly for investment, rather than for conspicuous consumption.

Source: Papanek, Gustav, *Pakistan's Development: Social Goals and Private Incentives* (Cambridge, Mass.: Harvard University Press, 1967), 242–3.

social sectors such as education and health. Viqar Ahmed and Rashid Amjad argue that after the cut in foreign aid in 1965, with foreign exchange down and defence spending up, the ensuing economic crisis between 1965 and 1967 was a key cause of Ayub Khan's downfall. The sugar crisis of 1967/8 acted as a major trigger to a smouldering feeling of discontent. Prices had risen by 15 per cent in 1965/6 and 10 per cent in 1966/7, adding fuel to the fire. Along with these factors, there was what Viqar Ahmed and Rashid Amjad call a *popular feeling* that inequality had increased. They argue that

> a major factor responsible for this feeling was the considerable increase in the level of conspicuous consumption and wasteful expenditure on extravagant and lavish housing and other consumer durables by the richer classes in the country. Also, even if the actual level of income distribution had not worsened, the number of people living in abject poverty was still very significant and the display of conspicuous consumption in the face of this extreme poverty stirred considerable tension and finally led to an outbreak of unrest in the country.[63]

Interestingly though, Table 6.10, which shows income inequality over the period, indicates that inequality actually decreased in the 1960s.

While there are differences of opinion about the extent of inequality as a result of the policies pursued under Ayub, there is no denying the fact that interregional disparity between West and East Pakistan did worsen. Even Gustav Papanek accepted the presence of high inequality between the two provinces, although he was able to justify this through an argument that endorsed the social use of inequality (see Box 6.4). Economists, especially in East Pakistan, were great critics of this policy and argued that all the growth or development that had taken place was in West Pakistan and that there had been a transfer of resources from East to West (Tables 6.11 and 6.12 give some indication of this phenomenon).[64] Stephen Lewis shows that the level of per capita income in West Pakistan was only 10 per cent higher than in East Pakistan in 1949/50. This disparity had risen to over 30 per cent in 1964/5. The 'East Pakistanis complained that not only were they less well off at the time of Partition, but they also had been exploited by the West wing to provide resources for development in that richer province.'[65] (Further discussion of regional inequality takes place in Chapter 18.)

Table 6.10
Income Distribution in Pakistan: 1963/4 and 1969/70

% of households	% of income	
	1963/4	1969/70
0–10	2.3	3.2
10–20	4.1	4.8
20–30	5.0	5.6
30–40	6.1	6.6
Lowest 40%	17.5	20.2
40–50	7.1	7.4
50–60	8.4	8.6
60–70	9.8	10.0
70–80	11.9	11.8
Middle 40%	37.2	38.0
80–90	15.1	14.7
90–100	30.2	27.1
Highest 20%	45.3	41.8
Gini coefficient		
National	0.386	0.336
Rural	0.362	0.304
Urban	0.433	0.367

Note: Income shares according to each decile of household have been estimated by fitting a (Lorenz) curve to the cumulative share of various income groups in total households and income derived from the Household Income and Expenditure Survey for the respective years.

Source: Government of Pakistan, *Pakistan Economic Survey 1984–85* (Islamabad, 1985).

Table 6.11
Per Capita GDP in East and West Pakistan at 1959/60 Constant Prices

Year	Per capita GDP East	Per capita GDP West	West–East disparity ratio	Index of disparity
1959/60	269	355	1.32	100
1964/5	293	426	1.45	141
1969/70	314	504	1.61	191

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82*, Oxford University Press, Karachi, 1984, 89.

Table 6.12
Index of Disparity in Per Capita Income (West Minus East; Divided by West)

Year	Index of disparity
1949/50	17.9
1954/5	19.5
1959/60	24.5
1964/5	31.1
1969/70	37.9

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 89.

6.3 1972–77: The Bhutto Years—Bad Luck or Bad Management?

If there was any economic continuity between the first and second decades, it seems to have all but evaporated between the Ayub and Yahya regimes and that of Zulfikar Ali Bhutto. In many ways, there was a clear break from the past, as more than half of what was Pakistan from 1947 to 1971, had seceded to become an independent country, Bangladesh. Bhutto inherited a new Pakistan, defeated in war by India, and he came to power as Pakistan's first democratically elected leader. These differences from the past were sharp enough, but not only was the political set-up different, Bhutto's economic policies also made a sharp break from the pro-private sector strategies of the earlier years. Bhutto's regime has come in for a lot of criticism for 'destroying' the economy. Critics have argued that his strange concept of socialism was responsible for the dismal growth rates and for the highest rates of inflation ever seen in Pakistan. They have argued that it was poor policies and bad economics which caused the malaise. We examine these claims and also see how factors not in the control of the government affected economic performance. Our interpretation suggests that numerous 'bad luck' factors played a critical role in causing the economy to grow at below trend rates.

There is no doubt that the growth rates of the 1950s and 1960s were particularly impressive. It is also unlikely that those growth rates could have been sustained unless other institutional factors were also changed. Thus, it was inevitable, and more so after the independence of East Pakistan, that the rate of growth would decline. The performance of the Bhutto regime must be seen in the context of the circumstances in which it took over power and the problems that it inherited.

Table 6.13 shows the annual growth rates for GDP and its constituents for 1971/2 to 1976/7. A comparison with the 1950s shows that the growth rates for GDP overall were higher in this period than in the 1950s, although in manufacturing the 1950s had higher rates, while in agriculture the two periods were somewhat similar. For services, given the more developed economy in the 1970s, the growth rate was higher then, despite the fact that industry and agriculture, which form a close link with services, were not growing at the rates of the 1960s. Services grew by 5.7 per cent even when in 1974/5 growth rates in agriculture and manufacturing were both negative. In fact, in each of the three years from 1972 to 1975, the annual growth rate in all services considered together was actually above 10 per cent.

Table 6.14 shows the rates of inflation over the Bhutto period. By any standard, inflation was high in most years of the Bhutto government, especially compared with the very low 3.83 per cent average for the 1960s (however, see section 6.3.2 for an explanation).

Before we turn to an evaluation of the Bhutto government's policies, a word about the data is of particular interest. The Ayub Khan government fell in 1968 and Bhutto took over from General Yahya Khan in December 1971. However, some studies, when examining the performance of the Bhutto period, lump the post-Ayub three years with the Bhutto period, distorting the facts. One example is Nawab Haider Naqvi and Khwaja Sarmad's study, which in its evaluation of Pakistan's economy in the 1970, considers 1969/70 to 1976/7 as one homogenous period and produces average growth rates for the whole of it.[66] The Bhutto period was a distinct period, so clubbing it with the Yahya period does not reveal the true nature of the Bhutto regime. The Pakistan Economic Survey of 1984/5 makes the same mistake and provides average growth rates for the period 1970–7, calling it the 'Non Plan' period.[67] While there may have been no implementation of the Five-Year Plans produced between 1970 and 1977, to evaluate the performance of the Bhutto regime the correct time-frame needs to be kept in mind.

Table 6.13
Annual Growth Rate 1971–77 at 1959/60 Factor Cost (% per annum)

Year[a]	Agriculture	Manufacturing: Large scale	Manufacturing: Small scale	Wholesale and retail trade	Banking and insurance	Public administration and defence	Services	GDP
1971/2	3.5	–6.8	7.2	–0.5	0.8	6.8	5.1	1.2
1972/3	1.7	11.9	7.3	6.7	29.1	14.1	5.2	7.2
1973/4	4.2	7.5	7.3	14.9	6.4	14.8	5.4	7.7
1974/5	–2.1	–1.7	7.3	3.2	14.4	33.2	5.7	3.9
1975/6	4.5	–0.5	7.3	1.8	3.3	–3.0	5.7	3.3
1976/7	2.5	–0.2	7.3	–0.3	8.2	7.3	3.2	2.9
1971–1977 (ave.)	2.4	1.7	7.3	4.3	10.4	12.2	5.1	4.4

[a]The annual growth rate for 1971/2 means the rate for the period 1970/1 to 1971/2.
Source: Government of Pakistan, *Pakistan Economic Survey 1984–85* (Islamabad, 1985).

Table 6.14
Inflation Rates in Pakistan: 1970–80 (% per annum)

Year	Annual rates of change in the general price level
1970/1	5.71
1971/2	4.69
1972/3	9.7
1973/4	29.98
1974/5	26.73
1975/6	11.66
1976/7	9.24
1977/8	6.89
1978/9	8.33
1979/80	10.44
Growth rates for selected periods[a] (% per annum)	
1969/70 to 1976/7	13.96
1976/7 to 1979/80	8.55
1969/70 to 1979/80	12.34

[a]Growth rates are trend values significant at the 95 per cent confidence level.

Source: Naqvi, S. N. H. and Khwaja Sarmad, *Pakistan in the Seventies* (Islamabad: PIDE, 1993).

Figure 6.1
Bhutto's Nationalization Programme: 1972–77

20 December 1971	Zulfikar Ali Bhutto takes over as President of Pakistan.
January 1972	Public takeover of 31 large firms in 10 basic industries: iron and steel, basic metals, heavy engineering, motor-vehicle assembly and manufacture, tractor assembly and manufacture, heavy and basic chemicals, petrochemicals, cement and public utilities
March 1972	Land reforms
March 1972	Management and control of 32 life insurance companies
May 1972	Banking reforms; State Bank of Pakistan extends controls over scheduled banks, reorientating credit policy towards small farmers and small industrial entrepreneurs
May 1972	Devaluation of the rupee by 131 per cent
June 1972	Comprehensive labour reforms
August 1972	Comprehensive public health programme
September 1972–September 1974	Nationalization of educational institutions
June 1973	Trade in cotton and rice nationalized
September 1973	Vegetable oil, petroleum marketing, and shipping nationalized
January 1974	Nationalization of all private and domestically owned banks
August 1976	Cotton ginning, rice husking, and flour milling nationalized

6.3.1 Economic Policies and Performance

In its election manifesto, the Pakistan People's Party had promised the nationalization of all basic industries and financial institutions. The manifesto had said that 'those means of production that are the generators of industrial advance or on which depend other industries must not be allowed to be vested in private hands; secondly, that all enterprises that constitute the infrastructure of the national economy must be in public ownership; thirdly, that institutions dealing with the medium of exchange, that is banking and insurance, must be nationalized'.[68] The economic policies of the Bhutto government rested on the premise that the control of the leading enterprises was to be in the hands of the state. Figure 6.1 highlights the salient features of the nationalization agenda of the Bhutto government.

The first phase of nationalization took place in the large-scale manufacturing sector, essentially in the capital and intermediate goods industry. This produced a small share of the total value added of the sector (less than 20 per cent) since much of the growth in this sector had taken place in the consumer goods industries. The nationalization programme was later extended to the vegetable oil sector and then to cotton ginning and rice milling. The nationalization of banks and insurance companies was a critical assault on the close link that had built up between industrial and financial capital since the mid-1950s. This link had been one of the causes of the economic concentration that became a political issue in the late 1960s. The Party's promises to urban organized labour, as to rural peasants and agricultural workers, were fulfilled within six months of coming to power through the labour reforms and land reforms of 1972. The devaluation of the Pakistani rupee by 131 per cent had important repercussions as we show below, and 'removed at one stroke the subsidy the industrialists had received in the earlier period because of the overvalued exchange rate. This reform, together with the increase in procurement prices of agricultural goods (which went up by about 100 per cent in this period), made a deliberate attempt to alter the pro-industry anti-agriculture bias of the previous growth strategy.'[69] The Export Bonus Scheme, a key feature of the 1960s, was also abandoned.

The impact of the government's policies must be seen in the context of what the government had inherited. The loss of East Pakistan, if for no other reason, was important because 50 per cent of West Pakistan's products found their way into East Pakistan in 1969/70, and the loss of such a large

market was cause for concern enough. Furthermore, 18 per cent of the West's imports came from East Pakistan. Hence, new markets had to be found immediately to compensate for this loss of market. The success of the devaluation measure was apparent soon after, when new markets were found and

> the value of export to areas other than the former East Pakistan rose by 41 per cent in the financial year 1972 and 39 per cent in the financial year 1973. This reflected both a sharp jump (about one-third) in the size of the cotton crop in the exports of cotton and cotton textiles, and the successful diversion of most of the flow of cotton, textiles, rice, and other goods with which West Pakistan had previously reimbursed East Pakistan for its flow of jute and jute earnings to West Pakistan.[70]

Exports in 1972/3 increased by 153 per cent over the previous year,[71] and manufactured exports grew by 19 per cent in 1973/4, which, according to the Asian Development Bank, 'was due to favourable world demand conditions for cotton textiles, and the capacity available for production for exports following the loss of the East Wing market in 1971'.[72] The growth in exports was a key factor in the growth in industrial output between 1972 and 1974 (see Table 6.15). Agricultural output also rose, and this was attributed to 'the higher support prices for wheat, rice, sugar, and timely and adequate supply of essential inputs'.[73] Availability of credit also played a vital role in the improved performance, for after May 1972 when the government had tightened its control over the banking system, more credit was available to the export sector and to small farmers. The export refinance scheme was started by the State Bank of Pakistan in 1973, and its lending rate was lower than the nominal banking rate or the kerb market rate.

The economic boom of 1972/3 and 1973/4 seemed to be fairly short-lived and was attributed to the rebound of domestic demand following the disruption in the economy in the early 1970s and to the worldwide commodity boom. However, the world recession after 1974 considerably slowed the demand for Pakistani exports. After about two and a half years of impressive growth, the last three years of the Bhutto government saw the trend substantially reversed with dismal growth rates. Viqar Ahmed and Rashid Amjad argue that those last three years of the Bhutto regime also 'coincide with the 'big-push' in public sector investments in long gestation projects and show a dismal performance in both the agricultural and manufacturing sector'.[74]

One outcome of the nationalization measures was the complete reversal of public and private investment. The substantial contribution by the private sector in the 1960s was cut down at a stroke. In 1974/5, the height of the Bhutto regime's nationalization programme, private sector investment was only 15 per cent of its 1969/70 level (see Table 6.16). Public sector investment, which was 5 per cent of the total in 1970/1, rose to 75 per cent at the end of the Bhutto era. These figures may suggest that the Bhutto regime's nationalization programme alone was responsible for this trend, but it is important to realize that 'private investment had already started to climb down even before nationalization struck it down in 1972',[75] and that the decline in investment during the second half of the 1960s, which indicates that growth in large-scale manufacturing had slowed, was a trend which continued into the 1970s. However, there is no doubt that the anti-industrialist policies and great uncertainty of the 1972–7 period were also responsible for the lack of private sector investment. The private sector had lost all trust in the government, for Bhutto had broken his promises: 'his assurance of no further nationalization [prior to nationalizing the vegetable oil industry in September 1973] until the elections of 1977 no longer seemed meaningful and the little confidence that the businessmen had developed in the regime was now completely gone'.[76] Such promises were broken time and time again.

6.3.2 The Bad Luck Factor

The fact that the economy suffered after 1974 is clear. The reasons, for this, however, are open to some debate. Figure 6.2 shows that a number of events that took place outside the control of the government were largely responsible for the poor performance of the economy after 1974. There was a very large increase in the prices of imports following the oil price rise in 1973, which resulted in inflation at close to

Table 6.15
Trade Pattern: 1970–77

Year	Exports	Imports	Balance	Exports	Imports	Balance
		(Rs. m)			($ m)	
1970/1	1,998	3,602	–1,604	420	757	–337
1971/2	3,371	3,495	–124	591	638	–47
1972/3	8,551	8,398	153	817	797	20
1973/4	10,161	13,479	–3,318	10,626	1,362	–336
1974/5	10,286	20,952	–10,666	1,039	2,114	–1,075
1975/6	11,253	20,465	–9,212	1,137	2,067	–930
1976/7	11,294	23,012	–11,718	1,141	2,325	–1,184

Source: Government of Pakistan, *Pakistan Economic Survey 1995–96* (Islamabad, 1996).

Table 6.16
Investment and Growth Rates in the Large-Scale Manufacturing Sector 1969–80 at Constant Price Level of 1969/70 (Rs. m)

Years (1)	Private sector (2)	Public sector (3)	Total (4)	Relative share of public investment in total (%) (5)
1969/70	1,208.2	177.1	1,385.3	12.8
1970/1	1,038.4	58.3	1,096.7	5.3
1971/2	699.9	63.8	763.7	8.4
1972/3	313.1	45.1	358.2	12.6
1973/4	230.8	113.7	344.5	33.0
1974/5	182.8	276.8	459.6	60.2
1975/6	344.5	831.5	1,176.0	70.7
1976/7	369.0	1,085.3	1,454.3	74.6
1977/8	482.3	1,922.1	2,404.4	79.9
1978/9	459.7	1,944.9	2,404.6	80.9
1979/80	544.6	1,644.0	2,188.6	75.1
Growth rates for selected periods[a] (% per annum)				
1969/70 to 1976/7	–45.1	–b	–39.0	11.5
1976/7 to 1979/80	17.0	45.5	34.2	12.5
1969/70 to 1979/80	–[b]	39.8	11.7[c]	11.9

[a]Growth rates are trend values significant at the 95 per cent confidence level.
[b]Insignificant trend.
[c]values significant at the 90 per cent confidence level.
Source: Naqvi, S. N. H. and Khwaja Sarmad, *Pakistan in the Seventies* (Islamabad: PIDE, 1993).

Figure 6.2
Bhutto: The Bad Luck Factor?

20 December 1971	Zulfikar Ali Bhutto takes over as President of Pakistan.
May 1972	Devaluation of the Pakistani rupee; initial outcome highly positive with exports growing by more than 100 per cent
August 1973	Massive floods hit Pakistan; import of food grain.
October 1973	Four-fold increase in international petroleum prices; imports cost much more; prices of fertilizers, essential inputs and oil jump; excessive inflation domestically
1974–77	World recession follows OPEC price rise; demand for Pakistani exports remains severely depressed and affects industrial output.
1974–75	Huge failure of cotton crop by as much as 25 per cent at a time when international cotton prices had risen; affected industrial output
1976–77	Worst floods in Pakistan's history; agricultural crops destroyed; further import of food crops; excessive expenditure on public good measures, all affecting industrial output

30 per cent in 1973/4. The oil price rise had begun to affect the gains from devaluation and exports, and in one go wiped out the positive balance of trade from 1972/3. While export growth still showed some positive signs, albeit at a much slower pace, the import bill grew very significantly (see Table 6.15). In one year alone, oil imports rose from US$60 million in 1972/3 to $225 million in 1973/4; fertilizers increased from $40 million to $150 million in the same period.[77] The result of the huge rise in oil prices was an international recession that was not in the control of the Bhutto government.

Moreover, in the five years of the Bhutto government, floods and pest attacks damaged crops severely, putting pressure on prices and affecting industrial production.[78] The failure of the cotton crop in 1974/5 came at a time when there was a surge in international prices and hence Pakistan was not able to exploit the situation to its advantage. The year 1976/7 saw Pakistan's worst floods, devastating large areas of cultivated land.

Excessive inflation was seen as Bhutto's biggest failure, but a closer look at the management of the economy and of the growth in monetary assets suggests that much of the inflation was imported. Table 6.17 shows that excessive monetary growth took place only in the first and last of his five and a half years. The increase in 1971/2 was primarily due to the adjustments necessitated by the loss of East Pakistan and to the increase in exports. Viqar Ahmed and Rashid Amjad write that the economy had been well managed in the early years without excessive deficit financing despite the costs incurred due to the floods, and monetary expansion had been kept well in line with GNP growth, and was 'almost entirely limited to the private sector. There had in fact been an overall contractionary effect in the government and foreign sector'.[79] A very negative perception seems to have become part of the literature on the Bhutto period, where, despite the facts, a number of observers believe that the economy under Bhutto was in a shambles. William McCleary, for example, argues that there was 'generally poor performance and relative stagnation in the 1970s', and that a 'lack of fiscal and monetary discipline led to high budget deficits, rapid monetary growth, and inflation'.[80]

Mohsin S. Khan of the IMF, however, has also made an important intervention in the debate over Bhutto's economy, and particularly about the rate of inflation. He writes that 'a good part of the increase in the earlier period [of the Bhutto era] was a result of the oil price shock in 1973/74. If these two years are dropped from the case, the average annual rate of inflation in the 1970s falls to less than 10 per

Table 6.17
Differential Growth Rates of Money Supply, GDP, and Commodity-Producing Sectors: 1969–80 (% per annum)

Years (1)	Growth of money supply[a] (2)	Growth of real GDP (3)	Growth of commodity producing sectors (4)	Excess of col. (2) over col. (3) (5)	Excess of col. (2) over col. (4) (6)
1969/70	10.69	9.78	10.07	0.19	0.62
1970/1	10.80	0.30	–1.42	10.50	12.20
1971/2	42.66	1.17	1.35	41.49	41.31
1972/3	14.21	7.21	4.25	7.00	9.96
1973/4	11.06	7.74	5.24	3.32	5.82
1974/5	12.44	3.94	–1.26	8.50	13.70
1975/6	11.14	3.32	3.48	7.82	7.66
1976/7	24.30	2.53	1.98	21.77	22.32
1977/8	22.97	7.38	4.63	15.59	18.34
1978/9	20.20	4.90	3.90	15.30	13.30
1979/80	18.51	7.28	7.88	11.23	10.63
		Growth rates for selected periods[b] (% per annum)			
1969/70 to 1976/7	15.72	4.22	2.21	11.50	13.51
1976/7 to 1979/80	18.66	6.16	5.17	12.50	13.49
1969/70 to 1979/80	16.50	4.59	2.84	11.91	13.66

[a]Growth rate for 1969/70 means the rate for the period from 1968/9 to 1969/70.
[b]Growth rates are trend values significant at the 95 per cent confidence level.
Source: Naqvi, S. N. H. and Khwaja Sarmad, *Pakistan in the Seventies* (Islamabad: PIDE, 1993).

cent. . . . Certainly, it is not obvious from the numbers that the 1970s were characterized 'by generally poor performance and relative stagnation' or that the 1980s were so much better on all fronts.'[81] Shahid Javed Burki, otherwise a critic of Bhutto's politics, also maintains that 'Pakistan's performance during the seventies appears unsatisfactory only when compared to that of the sixties. The seventies produced a better overall record compared to the fifties. . .'.[82]

The key causes of low growth in the mid-1970s were possibly an extremely adverse weather cycle along with an international recession. Government policy did not help much either, where industrialists were eyed with suspicion, and in response to government fears and threats the industrialists created artificial crises. While organized labour felt that it had a greater right to the share of industrial produce, industrialists feared more lock-outs or outright nationalization. Entrepreneurs were demoralized and unwilling to invest. Capital and capitalists had fled overseas and it was clear that the economy and industry were faced with a severe crisis, no matter what the causes may originally have been. The Bhutto era has been considered one of Pakistan's worst economically. Nawab Haider Naqvi and Khwaja Sarmad have argued that this period was 'a period of domestic and international economic turmoil, significant external shocks and economic dislocation and disruption'.[83] We have tried to show that (1) things were not as bad as they seemed, given the conditions inherited and the odds against Bhutto, and (2) it was more bad luck than bad management which resulted in poor economic growth rates. The implications and consequences of the Bhutto regime for the social and political evolution of Pakistan are addressed in Part VI of this book.

6.4 Summary and Further Reading

6.4.1 Summary

This is an important chapter because it examines the history of the industrialization process over the first three decades of Pakistan's existence, and examines specific policies pursued by different regimes to further the goals of industrialization. In the first decade, the exchange rate and the trade regime played an important role in determining the direction of industrial development in Pakistan, laying the ground for later years. Starting from an almost non-existent industrial base, economic growth in the period 1947–58 was impressive. It became even more astonishing in the Decade of Development under Ayub Khan between 1958 and 1968.

Industrial development showed extraordinary growth rates under Ayub, and there was a perception that Pakistan would soon emerge as one of the few underdeveloped countries to join the ranks of the developed world. Moreover, while agriculture suffered severely during the 1950s, in the 1960s the Green Revolution brought about an equally impressive transformation, complementing industrial growth. Overall economic development was quite phenomenal in this period. There was also a downside to this capitalist development, as is always the case. Inequalities between East and West Pakistan

increased, as did those between different economic and social classes. However, despite these inherent contradictions in the mode of capitalist development under the Ayub regime, we argue that the economic programme and policies followed resulted in extremely impressive growth. Rather than being labelled as a failure, the Ayub regime was dynamic and a 'success' by whatever criteria were available at that time to measure success.

The Bhutto era represents a significant break with the past. With more than half the country now an independent nation, Bhutto assumed leadership of a war-torn Pakistan and inherited extremely difficult conditions. Despite this, the first two years of his five-and-a-half year rule showed exemplary growth by any standard. In the subsequent years, however, a large number of factors over which Bhutto had no control resulted in a slowing down of the growth rate and of economic development, especially after the high-growth 1960s. We argue that it was not bad management that caused economic deterioration in the Bhutto period, but bad luck.

This chapter makes an important contribution to the debate over economic growth and development during the first three decades, by contesting and arguing against some of the more popular myths that have emerged about this period in the literature.

Firstly, we argue that the import substituting industrialization policy pursued in the first decade was the right policy *for that time*, and that a careful and selective manipulation of key economic variables resulted in an industrial base being formed. Secondly, we argue that Ayub Khan's Decade of Development was indeed that—not a failure of development, as some observers contend—and that the contradictions that emerged were all inherent in the policies pursued. This was, probably, Pakistan's Golden Age. And lastly, we show that the Bhutto government suffered the consequences of bad luck, both domestic and international. Not only was Bhutto not wholly responsible for the poor performance, but the extent of that poor performance has, itself, been grossly exaggerated. Economic performance was not half as bad as we have generally been led to believe.

6.4.2 Further Reading

Some of the best academic work on Pakistan looks at the period 1960–70 and the growth model adopted in this period. Since industry was a major component of growth, many of the best works on Pakistan examine industrial performance in the earlier years. The two books by Stephen R. Lewis, Jr, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen and Unwin, 1969) and *Pakistan: Industrialization and Trade Policies* (London: George Allen and Unwin, 1970) are classics which examine in great detail the early period following Pakistan's independence. Gustav Papanek's *Pakistan's Development: Social Goals and Private Incentives* (Cambridge, MA: Harvard University Press, 1967) also covers the early period, and is a first-hand account by someone who was involved in public policy. Other books on this period include White, L. J., *Industrial Concentration and Economic Power in Pakistan*(Princeton, NJ: PUP, 1974); MacEwan, Arthur, *Development Alternatives in Pakistan* (Cambridge, MA: Harvard University Press, 1971); and Madison, A., *Social Development in Pakistan, 1947–1970* (Cambridge, MA: Harvard University Press, 1971).

On the industrial policy of the Ayub Khan era, good references are Rashid Amjad's *Private Industrial Investment in Pakistan, 1960–1970* (Cambridge: University Press, 1982) and two PhD dissertations, one by Meekal Ahmed, 'Productivity, Prices and Relative Income Shares in Pakistan's Large Scale Manufacturing Sector, 1958–70', University of Oxford, 1980, and A. R. Kemal, 'An Analysis of Industrial Efficiency in Pakistan, 1959–60 to 1969–70', University of Manchester, 1978.

For the Bhutto period, see Shahid Javed Burki's *State and Society in Pakistan, 1971–77* (London: Macmillan, 1980); Adams, J. and Sabiha Iqbal, *Exports, Politics and Economic Development in Pakistan* (Lahore: Vanguard, 1987); and two doctoral dissertations, Maleeha Lodhi's, 'Bhutto, the Pakistan People's Party and Political Development in Pakistan', London School of Economics and Political Science, 1980, and Zareen F. Naqvi's 'Distributional Impact of Public Enterprise Operational Policies in Pakistan', Boston University, 1994.

Some texts worth studying in greater detail which look at all three of the periods covered in this chapter are: Viqar Ahmed and Rashid Amjad's *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984); Asad Sayeed's excellent 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', PhD dissertation, University of Cambridge, 1995; and Parvez Hasan's *Pakistan's Economy at the Crossroads: Past Policies and Present Imperatives* (Karachi: Oxford University Press, 1998).

NOTES

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2. Ibid. 1–2.
3. *The New York Times*, 18 January 1965, quoted in Papanek, op. cit., 1967, 1.
4. *The Times*, London, 26 February 1966, quoted in Papanek, op. cit., 1967, 1.
5. This section makes extensive use of Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: George Allen and Unwin, 1969); Lewis, Stephen, *Pakistan: Industrialization and Trade Policies* (London: George Allen and Unwin, 1970); and Papanek, Gustav, op. cit., 1967.
6. Lewis, Stephen, op. cit., 1969, 67–68.
7. Ibid. 68.
8. Ibid. 3.
9. Unless otherwise stated, all figures in the text are for West Pakistan only.
10. Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi:Oxford University Press, 1984), 65.
11. Ibid. 64.
12. Papanek, Gustav, op. cit., 1967, 145.
13. Lewis, Stephen, op. cit., 1969, 157.
14. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 68.
15. Ibid. 243.
16. Lewis, Stephen, op. cit., 1969, 7.
17. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 66.
18. Ibid., 66; see also Papanek, Gustav, op. cit., 1967, on this point.
19. Institute of Developing Economies, *The Study on Japanese Cooperation in Industrial Policy for Developing Economies: Pakistan* (Tokyo: IDE, 1994), 123.
20. Lewis, Stephen, op. cit., 1969, 13.
21. This section makes liberal use of Lewis, Stephen, op. cit., 1969, and Lewis, Stephen, op. cit., 1970.
22. Lewis, Stephen, op. cit., 1969, 76.
23. Ibid. 40.
24. Ibid., 75, emphasis added.
25. Ibid. 111.
26. Ibid. 70.
27. Ibid. 73.
28. Ibid. 110.
29. Ibid. 106.
30. Ibid. 7–8.
31. Ibid. 10.
32. Ibid. 46.
33. Papanek, Gustav, op. cit., 1967, 34.
34. Ibid. 67.
35. Ibid. 88.
36. Ibid. 92.
37. Ibid. 104.
38. Ibid. 101.
39. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 67.
40. Ibid. 77.
41. Ibid. 77.
42. Papanek, Gustav, op. cit., 1967.
43. Lewis, Stephen, op. cit., 1969, 10.
44. Amjad, Rashid, *Private Industrial Investment in Pakistan, 1960–1970* (Cambridge: Cambridge University Press, 1982), 5.
45. Asian Development Bank, *Strategies for Economic Growth and Development: The Bank's Role in Pakistan* (Manila, 1985), 359.
46. Institute of Developing Economies, op. cit., 135–6.
47. Ibid.
48. Asian Development Bank, op. cit., 359.
49. Lewis, Stephen, op. cit., 1969, 46.
50. Asian Development Bank, op. cit., 366.
51. Ibid. 366.
52. Cited in Cheema, Ali, 'Pakistan's Textile Policy and Trade Performance: 1972–1990', mimeo (Cambridge: Sidney Sussex College, 1995), 3.
53. Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995, 55.
54. Ibid. 56.
55. Papanek, Gustav, op. cit., 225, emphasis added.
56. In Amjad, Rashid, op. cit., 1982, 11.
57. Ibid. 10.
58. Ibid. 166.
59. Papanek, Gustav, op. cit., 221.
60. Amjad, Rashid, op. cit., 1982, 12.
61. Cheema, Ali, op. cit., 1995, 7.
62. All figures are from Amjad, Rashid, op. cit., 1982.
63. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 90.
64. Ibid. 89.
65. Lewis, Stephen, op. cit., 1969, 4.
66. Naqvi, S. N. H. and Khwaja Sarmad, *Pakistan's Economy Through the Seventies* (Islamabad: PIDE, 1984), 12.
67. Government of *Pakistan, Pakistan Economic Survey 1984–85* (Islamabad, 1985), 22.
68. Institute of Developing Economies, op. cit., 161.
69. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 3.
70. Institute of Developing Economies, op. cit., 185.
71. Government of Pakistan, op. cit., 1985, 195.
72. Asian Development Bank, op. cit., 380.
73. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 94.
74. Ibid. 95.
75. Naqvi, S. N. H. and Khwaja Sarmad, op. cit., 1984, 38.
76. Burki, Shahid Javed, *State and Society in Pakistan 1971–77* (London: Macmillan, 1980), 118.
77. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 94.
78. Ibid. 92.
79. Ibid. 94.
80. McCleary, William, 'Pakistan: Structural Adjustment and Economic Growth', in V. Thomas et al. *Restructuring Economies in Distress (Oxford:* Oxford University Press, 1991), 414.
81. Khan, Mohsin S., 'Comments', in V. Thomas et al. *Restructuring Economies in Distress* (Oxford: Oxford University Press, 1991), 436.
82. Burki, Shahid Javed, 'A Historical Perspective on Development', in Burki, Shahid Javed and Robert Laporte, *Pakistan's Development Priorities: Choices for the Future* (Karachi: Oxford University Press, 1984), 19.
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7 The Process of Industrialization in Pakistan II: 1977–2013

After the fall of Zulfikar Ali Bhutto in July 1977, Pakistan can easily be delineated by two specific eras or periods. From 1977 to August 1988 General Zia ul-Haq ruled Pakistan, the longest rule ever by a single individual in Pakistan's sixty-six years of existence. Zia's military dictatorship varied from downright ruthlessness to a more benign form of praetorian democracy after 1985. Nevertheless, General Zia's authoritarian and dictatorial rule will always be remembered for the great damage it did to Pakistan's society and its values. In many ways, sadly, it has been Zia's politics and policies which have defined Pakistan for the last three decades, although there is hope that this is changing. Despite attempts to introduce participation, starting from the local bodies elections of 1979, General Zia never let go of the reins of power, a fact ably demonstrated in May 1988 when the elected government of Mohammad Khan Junejo was summarily dismissed. Zia ul-Haq was killed in an air crash in August 1988 and we can only speculate about the nature of developments in Pakistan had Zia not met his death in this fashion. Nevertheless, with the death of Zia, we saw much of his legacy still had a strong bearing on political and economic developments in Pakistan some decades on.

During the Zia era, Pakistan witnessed the return of high growth rates and an increased role for the private sector, in many ways reminiscent of the Decade of Development of the Ayub regime. But much had changed, in the form of class structures, social and political alliances, and the nature of the development of society, and the comparison between the Ayub and Zia periods makes very interesting reading.[1] This chapter will examine the policies of the Zia government with special emphasis on the process of industrialization. A comparison between the Ayub and Zia regimes and an analysis of social and economic outcomes under Zia are given in Chapter 26 and Chapter 27, as are the consequences brought about by the nine years of Pakistan's third military ruler, General Pervez Musharraf. However, Appendix 7.1 provides a flavour of the extent and result of differences between the two regimes, regarding the type of entrepreneurs that emerged.

Just as much as the 1977–88 period is distinct in its form and manner, the post-Zia period opens up a very different age in Pakistan's history, both politically and economically. There had been a return to democracy—or electioneering, more correctly—between 1988–99, with elections being held in Pakistan in 1988 after a lapse of eleven years, with three general elections held subsequently. Pakistan saw ten governments between 28 May 1988 and February 1997, and despite this high turnover, the military, which has always been prone to interfere in national politics in Pakistan, let the political process take its course until 1999 although it continued to manipulate, control, and dominate elected governments until General Pervez Musharraf overthrew the democratically elected government of Nawaz Sharif in October 1999 and took over power.[2] Interestingly, despite the frequent changes in government, the economic programme of different governments in Pakistan has been more or less the same, and one finds a great deal of continuity in policy, especially since September 1988.

Much of what has happened in the economic sector in Pakistan since 1988 has its genesis as part of a series of comprehensive Structural Adjustment Programmes undertaken under the close supervision of the International Monetary Fund (IMF) and the World Bank. Although Pakistan's adherence to IMF and World Bank policies began in earnest in 1980 when a large Extended Fund Facility programme was supported by the IMF, followed by many structural adjustment and sectoral loans from the World Bank, it would be fair to say that since 1988 Pakistan's economic programme has totally capitulated to the requirements of the IMF and the World Bank. Since then, Pakistan's numerous and varied governments have failed to come up with any independent economic or industrial development programme, and the very minutely detailed Policy Framework Papers of the IMF and World Bank have determined the nature and direction of policy. The most recent People's Party government of 2008–13 also undertook a $11.3 billion IMF programme soon after it came into office, as did the Nawaz Sharif government after May 2013, having been granted an IMF loan in September 2013. Going to the IMF is now the default mode for every government in Pakistan regardless of any adherence to perceived political ideology. Given the complete dominance of these two Washington organizations on the economic life of the country, the whole of Part VI of this book deals with the consequences for Pakistan of adhering to these structural adjustment policies. In this chapter, we try to limit ourselves to industrial policy and related issues. However, for a more comprehensive understanding of the industrial policy after 1988, a concurrent reading of Part VI is recommended.

There are two broad sections to this chapter: we examine first the process of industrialization in the Zia period, and second, the post-1988 era of structural adjustment.

7.1 THE ZIA YEARS: 1977–88[3]

7.1.1 The Nature and Extent of Growth

The phenomenal overall performance of the economy during this period can best be gauged from the following observation by Akbar Noman:

> according to *World Development Report 1990*, during 1980–88 Pakistan's GDP growth rate of 6.5 per cent was exceeded only by that of Korea, China and Hong Kong. . . . The growth of real wages in Pakistani manufacturing during 1980–88 was just about the fastest in the world—at 6.2 per cent a year surpassed only by Thailand (7.0%) and equalled only by Singapore.[4]

For the period 1978–86, S. N. H. Naqvi and Khwaja Sarmad show that GDP growth averaged 7 per cent consistency per annum.[5] According to the World Bank, manufacturing GDP grew at an annual average rate of 9.5 per cent between 1977 and 1986, and investment in medium- and large-scale industry grew at an average of 18.2 per cent per annum, while total private industrial investment expanded at 15.6 per cent per annum.[6] This is, indeed, a very impressive performance by any standard, whether in comparison with the performance of the Ayub regime or with the newly industrialized countries in the same period.

Table 7.1 shows the annual growth rate in value of output, labour, and other indicators for a large number of manufacturing industries in the period 1978–88. The total average growth in this period was a very impressive 9.6 per cent, with the first half of the Zia era showing an even higher rate of 12.8 per cent.[7] In both the Fifth and Sixth Five-Year Plans (1978–83 and 1983–8), actual growth rates exceeded the targets of 12 per cent and 9 per cent, respectively,[8] a rare occurrence in Pakistan's economic record. Table 7.2 shows how the high growth rates were disaggregated over the Fifth and Sixth Five-Year Plans.

Although the growth figures are very impressive, Asad Sayeed writes that a significantly different, and much less rosy, picture emerges with productivity growth figures (fourth column in Table 7.1). Not only is the aggregate of 0.3 per cent per annum low compared to the 5 per cent growth in the 1960s, but also the variation across sectors is significant.[9] Furthermore, if we aggregate the total factor productivity (TFP) growth rates, we can see that consumer goods have negative TFP growth, with the exception of the wearing apparel industry. A fairly mixed picture is presented by the intermediate goods industry. Table 7.3 highlights the low contribution of TFP growth to overall growth during the decade. As much as 82.3 per cent of the overall growth was due to the growth in the capital stock, 14.5 per cent to labour, and only 3.17 per cent to TFP growth, compare this

Table 7.1
Growth Rates of Output, Labour, Capital Stock, and Total Factor Productivity: 1978–88

Industry sector	Output	Labour	Capital stock	Total Factor Productivity output	Total Factor Productivity
Food manufacturing	8.8	7.4	7.3	1.5	–1.1
Beverages industries	6.5	9.2	12.8	–5.9	–6.7
Tobacco	9.1	1.6	10.9	–1.4	–3.4
Textiles	8.6	1.5	9.4	3.0	3.1
Wearing apparel	21.0	21.9	10.4	7.9	4.5
Leather products	7.3	10.7	13.7	–6.0	–19.8
Footwear	8.2	10.0	7.8	–0.3	2.2
Ginning, pressing, and baling	5.1	2.3	3.1	2.1	–2.7
Wood and cork products	13.7	14.5	13.7	–0.1	–0.9
Furniture	13.3	11.8	23.6	–7.0	–11.8
Paper and paper products	10.7	7.6	13.8	–1.2	–6.4
Printing and publishing	10.1	7.6	13.9	–1.3	–2.9
Drugs and pharmaceuticals	11.3	8.2	13.8	–1.4	–3.3
Industrial chemicals	11.2	7.1	8.5	3.0	3.2
Other chemicals	11.2	8.8	8.2	2.9	7.0
Rubber products	4.8	3.8	16.3	–5.0	–2.9
Plastic products	18.3	11.7	13.4	5.4	3.3
Glass products	14.1	8.7	16.1	0.8	–0.5
Other non-metallic minerals	11.7	9.8	14.5	–2.2	–3.1
Iron and steel	17.0	15.3	32.9	–11.0	–12.1
Non-ferrous metals	–8.6	–0.6	4.3	–10.4	–2.7
Metal products	–0.9	1.0	8.8	–6.0	–5.9
Non-electrical machinery	17.6	7.5	5.6	11.1	5.3
Electrical machinery	13.3	5.7	11.7	3.2	–0.6
Transport equipment	9.8	3.3	8.5	4.3	9.6
Total (weighted)	9.6	5.8	10.3	0.3	–0.9

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 109.

Table 7.2
Average Annual Growth Rates of Value of Output: 1978–88
(Constant Prices 1976/7)

Industries (PSIC 3-digit)	1978–1988	5th Plan	6th Plan
Food	9.7	13.7	5.76
Beverages	10.1	16.5	5.08
Tobacco	8.2	11.5	5.63
Textiles	8.8	11.0	7.16
Wearing apparel except footwear	33.9	35.2	32.7
Leather products except footwear	14.2	–1.2	26.4
Footwear	48.5	38.0	71.0
Ginning, pressing, and baling	9.8	8.5	10.7
Wood and cork	21.2	23.8	19.0
Furniture	30.6	38.1	24.5
Paper and paper products	16.9	18.8	15.5
Printing, publishing, and allied services	10.6	15.2	7.0
Drugs and pharmaceuticals	11.8	12.0	11.6
Industrial chemicals	14.7	19.7	10.65
Other chemicals	13.3	13.4	13.3
Petroleum refining	10.3	22.8	0.3
Miscellaneous petroleum and coal	15.7	34.1	1.0
Rubber products	5.5	10.1	1.8
Plastic products	20.4	30.7	12.1
Pottery, china, and earthenware	11.5	20.1	5.8
Glass and glass products	18.8	27.3	15.0
Other non-metallic minerals	18.2	22.5	14.8
Iron and steel basic	19.1	19.9	18.5
Non-ferrous metals	15.0	10.5	23.3
Fabricated metal except machinery	7.9	6.0	7.3
Machinery except electrical	15.3	15.0	20.3
Electrical machinery	13.2	10.6	14.5
Transport equipment	12.9	–3.8	25.6
Scientific equipment	16.0	10.1	16.4
Sports goods	22.1	22.6	18.6
Others	12.1	1.3	10.6
Average growth (total)	10.4	12.8	9.9

Source: Institute of Developing Economies, *The Study on Japanese Cooperation in Industrial Policy for Developing Economies: Pakistan*, (Tokyo IDE, 1994), 257–8.

to the figures presented in the previous chapter in Table 6.8. Asad Sayeed writes that in the case of Pakistan not only is the contribution of TFP significantly lower than that of the developing country average, but the contribution of capital is also inordinately high.[10]

Table 7.4 shows that there had been very little growth in employment in almost all industries between 1975 and 1986, and that the growth in labour productivity had also fallen in many industries. Interestingly, although the wearing apparel industry experienced the greatest increase in employment, it also saw output fall by nearly 19 per cent. A UNIDO report on the manufacturing sector gives the reasons for this low employment generation and says that

> an underlying feature of industrialization in Pakistan is the deteriorating performance of the manufacturing sector in generating new employment opportunities. Although the decade of the 1980s has been a period of relatively high growth in manufacturing value added, the growth in manufacturing employment has remained insignificant. This partly represents more an increase in capital industry than labour absorption during the period of accelerated expansion.[11]

Pakistan's manufacturing sector became more capital intensive between 1975 and 1986 and the share of wages and salaries in value added fell from 26.9 per cent in 1976 to 20.3 per cent in 1986.[12] A report published by the Institute of Developing Economies in Japan found it 'ironic' that

> some of the public sector dominated industries, such as electrical machinery and chemicals, show a high rate of growth in labour productivity. Firstly, we would expect labour productivity to be higher in capital-intensive projects where the labour–output ratio is high. And secondly, as large firms attain a higher level of capacity utilization, labour productivity will be expected to increase.[13]

Table 7.3
Decomposition of Manufacturing Growth: 1978–88

Industry sector	α	β	Share of labour %	Share of capital %	Share of TFP %
Food manufacturing	0.13	0.87	11.20	71.92	16.88
Beverages industries	0.11	0.89	16.02	176.25	-92.27
Tobacco	0.40	0.96	0.63	115.37	-16.00
Textiles	0. 49	0.51	8.30	55.75	35.96
Wearing apparel	0.24	0.76	24.75	37.73	37.53
Leather products	0.13	0.87	19.69	161.75	-81.44
Footwear	0.29	0.71	35.86	67.34	-3.20
Ginning, pressing, and baling	0.18	0.86	6.35	51.92	41.73
Wood and cork products	0.24	0.76	24.91	76.06	-0.97
Furniture	0.28	0.72	24.92	128.44	-53.36
Paper and paper products	0.30	0.70	21.50	89.81	-11.31
Printing and publishing	0.40	0.60	29.63	82.99	-12.62
Drugs and pharmaceuticals	0.20	0.80	14.59	97.61	-12.20
Industrial chemicals	0.23	0.77	14.26	58.59	27.16
Other chemicals	0.20	0.80	15.77	58.35	25.88
Rubber products	0.52	0.48	40.86	165.93	-106.80
Plastic products	0.34	0.66	21.75	48.36	29.89
Glass products	0.38	0.62	23.41	70.75	5.84
Other non-metallic minerals	0.13	0.87	10.63	108.69	-19.32
Iron and steel	0.28	0.72	25.66	138.61	-64.27
Non-ferrous metals	0.50	0.50	3.61	-25.20	121.59
Metal products	0.47	0.53	-56.54	-529.97	686.51
Non-electrical machinery	0.47	0.53	19.86	16.95	63.19
Electrical machinery	0.27	0.73	11.56	64.50	23.94
Transport equipment	0.58	0.42	19.71	36.12	44.17
Total (weighted)	0.24	0.76	14.50	82.33	3.17

Note: Alpha and beta refer to shares in values added for labour and capital in the year and capital in the base year respectively.
Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 111.

7.1.2 Industrial Policy

For Asad Sayeed, the 1978–88 period 'is the only epoch in the country's 48-year history when an industrial policy was formulated and executed for any length of time'.[14] S. N. H. Naqvi and Khwaja Sarmad see the Zia regime consisting of two sub-periods, 1978–81 and 1982–6,[15] while for the Institute of Developing Economies, Tokyo, there were three such periods: 1977–81, which was the period of 'cautious attempts at dismantling existing government policies and restoring confidence in the private sector, while simultaneously trying to gain political legitimacy'; 1982–5, 'a more forceful drive towards Islamization which followed the regime's consolidation of power'; and 1985–8, the 'attempt to disengage the government from direct control of the economy'.[16]

One of the most important concerns of the new Zia regime in mid-1977 was the need to restore business confidence and, particularly, private sector confidence and motivation, in order to revive investment in industry and agriculture, in order to improve the economy's performance substantially compared to the less than impressive performance during the Bhutto period. The military government of General Zia ul-Haq, like the military government of Field Marshal Ayub Khan, made the decision that the private sector was to play the leading role in the industrial sector.

Amongst the earliest steps taken by the Zia government in September 1977, to appease the private sector, was the denationalization of a number of agro-based industries—rice husking, flour milling, and cotton ginning—which were run inefficiently and were heavily 'in the red', along with the denationalization of some small engineering units as well.[17] In December 1977, a number of basic and heavy chemical and cement industries were opened up to the private sector, which was also given further incentives, such as tax holidays in March 1978, which were essentially aimed at encouraging industrial activity in the less developed regions of the country. Export rebates were also given priority, and in June 1978 the interest rate on fixed investment in agriculture and industry was also reduced. Some attempts were also made by the new military government to ease economic controls and regulations, including the procedures for the sanctioning of private sector investment.[18]

If the prominence given to the private sector brought back memories of the Ayub Khan era, so did the return to planning

Table 7.4
Growth and Structure of Manufacturing Employment: 1975–86

Industry sector	Growth of employment in manufacturing	Structure of manufacturing employment		Labour growth of Value-added per employee (% at 1980 prices)
	1975–86	1975	1986	1975–86
Food products	3.58	9.9	12.9	3.53
Beverages	5.07	0.7	1.0	11.32*
Tobacco	2.82	1.7	2.1	1.11
Textiles	–1.64	50.6	41.1	–4.31
Wearing apparel, except footwear	14.75	0.2	0.9	–18.63**
Leather products	2.81	0.8	0.9	–1.88**
Footwear, except rubber or plastic	–2.03	0.3	0.3	–3.55**
Wood products, except furniture	7.46	0.3	0.5	–4.11
Furniture, except metal	3.75	0.2	0.3	2.24**
Paper and paper products	0.03	1.9	1.6	12.28
Printing and publishing	4.52	1.4	2.1	5.79**
Industrial chemicals	3.33	2.5	3.1	6.91
Other chemicals	3.88	3.1	4.2	5.42
Petroleum refineries	1.63	0.5	0.6	1.41
Misc. petroleum and coal products	6.79	0.1	0.1	3.97**
Rubber products	0.11	2.2	2.0	1.75
Plastic products	11.26	0.3	0.6	–
Pottery, china, and earthenware	5.77	0.3	0.5	–6.39**
Glass products	3.37	0.5	0.8	–4.71**
Other non-metallic mineral products	1.90	2.6	2.9	3.25
Iron and steel	9.64	4.1	7.5	1.16**
Non-ferrous metals	–5.51	0.1	0.1	–5.19**
Fabricated metal products	–3.17	2.7	1.9	3.12**
Machinery, except electrical	1.41	3.3	3.3	0.17
Machinery, electric	0.60	3.5	3.6	8.34
Transport equipment	–1.04	4.7	3.9	6.3
Professional and scientific equipment	–3.55	0.8	0.5	14.22
Other manufactured products	–1.01	0.7	0.6	7.96**

* 1975–82, ** 1975–80, *** 1975–85.
Source: UNIDO, *Pakistan: Towards Industrial Liberalization and Revitalization* (Oxford: Basil Blackwell, 1990), 19 and 22.

in the guise of the Five-Year Plans. As an Asian Development Report stated: 'with a change in government in 1977 came a change in industrial strategy. The new government reinstated the system of five-year plans, and the Fifth Five-Year Plan was launched in 1978/79.'[19] In fact, there had not been much planning after the very successful second Five-Year Plan of 1960–5, when the third was curtailed and handicapped by the cut in foreign aid and the political situation domestically. The Third Five-Year Plan was made redundant after East Pakistan became independent Bangladesh, and the Fourth Five-Year Plan was lost somewhere in Zulfikar Ali Bhutto's rule of five years, a period better known as the Non-Plan Period.

The investment programme of the Fifth Five-Year Plan gave very high priority

> to producer and investment goods industries with industry based on indigenous raw materials next in line. Apart from bringing back the private sector, the stress on the use of indigenous raw materials in industry was also seen as important to revive the sluggish performance of the agricultural sector. . . . The economic managers of the Zia regime were looking for short and medium term gains to accrue from a boost in textile exports.[20]

Growth in large-scale manufacturing was projected at the highly ambitious rate of 12 per cent per annum, a target which was, surprisingly, achieved.

The policy measure that distinguishes the Zia regime from all others before and after General Zia was that of Islamization. In fact, it became General Zia's government's and his own mission to purify Pakistani society from all the ills and evils that had become ingrained. Islamic laws were enacted and Commissions formed, and even the economy was brought under the influence of Islamic laws and principles. Writing in 1984, Viqar Ahmed and Rashid Amjad argue:

> The major hallmark of the current phase is the initiation of the process of Islamization of the country's economic structure. The cautious steps taken so far are few and the overall framework is yet to acquire an Islamic look. But this is a task of historic magnitude. Starting with a lag of many centuries during which little effort could be made to apply Islamic principles to the changing socio-economic conditions and institutional structure in Muslim countries, considerable homework needs to be done and this underlines the need for a slow but firm start. But, given the people's commitment to Islam and the Islamic principles of faith in God, social justice and fair play, the process which has been started is not likely to be reversed.[21]

They continue:

> Currently most of the government's effort in long-term management is concentrated on the process of Islamization which, in terms of the long-run impact on the economy, may surpass the restructuring of the development strategy and the Plan priorities. The process involves a basic transformation of the entire society and intra-social relationships in conformity with the tenets of Islam. Social justice in every walk of life by following the Islamic principles, especially in the distribution of income and wealth in favour of the poor, and the elimination of interest (*sood*) charged by banks are viewed as key features of the Islamization process.[22]

Although much was made of the Islamization programme of the Zia regime at that time, most critics of the regime felt that it was a ploy on the part of the military government in order to legitimize and perpetuate its hold on power. Anita Weiss argues that 'attempts by the state to develop an Islamic economic system are not substantive departures from capitalist industrial culture, but are instead substitutes for specific aspects of it'.[23] Islam became the veil behind which Zia and his coterie hid and perpetuated their authoritarian form of government. Although all the Islamic laws passed by that government still form part of the law of the land, the fanfare has died down and governments since Zia's have not (as yet) used Islam for propaganda purposes. Interestingly, while Viqar Ahmed and Rashid Amjad, writing at the height of the Islamization campaign and at the time of a strict military authoritarianism, like most other authors, gave the Islamization process extensive prominence, much of what has been written on the Zia period's economic programme after the death of the General does not give much importance to what was considered to be his key programme. While Islamic codes and regulations do prevail, they seem to exist mainly on paper (see Chapter 12 on banking).

7.1.3 The Public/Private Sector Divide

One would have thought that with the Zia government's penchant for the private sector the first step would have been large-scale denationalization and the return of assets seized and nationalized under the Bhutto regime. At the time when Bhutto was deposed, the public sector dominated industrial development and the private sector had been reduced to a much smaller role than under Ayub Khan. An immediate reversal was anticipated, but other than the small and insignificant measures mentioned above, very little denationalization took place. The major contribution by the Zia government in the early years was to give a 'clear signal to the private sector that the government expected future growth to come from its increased participation in industrial activity'.[24]

An Asian Development Bank report defends this action by the Zia regime on the following grounds:

> The military government made the decision that the private sector was to play the leading role in the industrial sector. However, the existing public industrial sector was quite large, employing over 50,000 persons, and a massive investment programme of over Rs. 40 billion was underway. Thus it was not practical for the Government to undertake any large-scale denationalization. Original owners were only prepared to take the units back if the losses accumulated since nationalization in 1972 were written off and the surplus workers fired. The Government could not do that because of political and administrative reasons. Neither was it possible to abandon the industrial sector investment programme because a large proportion of the funds had been either spent or committed in the form of international contracts. The Government therefore decided on a more gradual process of reorientation toward private sector-led industrial growth. To restore the confidence of the private sector, the agricultural processing industries taken over in 1976 were denationalized, and a number of industrial incentives similar to those existing during the 1960s were introduced. As for public sector industries, a programme for improving efficiency and profitability was initiated, and the investment programme was restricted to ongoing projects and to the balancing, modernization, and replacement (BMR) of existing public sector units.[25]

However, the study by the Institute of Developing Economies in Japan makes the rather more pertinent point that 'in contrast to its [the Zia regime's] rhetoric against the Bhutto government's economic agenda, the Zia government was hoping to reap the rewards from investments made by the previous regime'.[26] This study continues that, even at the time of the Sixth Five-Year Plan, there were no clear moves towards privatization: 'In fact, public sector industry was seen as playing an instrumental role in industrialization in particular and development in general'.[27] Moreover, the study goes on to make the very astute point that

> the political economy of the government's decision not to go on a large scale privatization drive was that it did not want to alienate those groups and classes which had benefitted from nationalization by seeking employment in the sector. This group also comprised the urban

> lower middle class, which had been the most potent political agitator in Pakistan's history.[28]

While there was no immediate reversal, there certainly was a marked slowing down. Table 7.5 shows that the public sector's share in total industrial investment fell from as much as 72 per cent in 1978–9 to less than 18 per cent ten years later. Although there was some increase in employment, this was mainly due to the projects originated earlier. The bulk of public sector investment during the first half of the Zia regime was going into ongoing projects. In the Fifth Five-Year Plan (1978–83) only 23 per cent of total public industrial outlay was on new projects.[29] In the early years of the Zia government, public sector output increased much more rapidly than private sector large-scale manufacturing output, but in the second half of the ten years, the growth of the private sector was faster.[30] The impetus of growth in the first three years of the Fifth Plan was the public sector, as many of the projects started earlier, especially in the fertilizer and cement sectors, came online.

Essentially then, while the Zia government was very favourably inclined towards the private sector and blamed much of the ills of the economy on Bhutto's economic policies, including nationalization, the Zia regime took a far more pragmatic and politically clever line by not denationalizing in haste. It encouraged the private sector by giving it greater incentives and removing controls, and by opening up sectors and areas previously exclusive to the public sector. Once the government realized that ownership and control of the public sector industries was an effective tool for granting political patronage and favour, there seemed little recourse to gift such a means away. The best example of this is the fact that the all powerful and important financial sector was retained by the government, and no denationalization or privatization of banks took place when General Zia was in power.

Table 7.5
Share of Public Industrial Enterprise in Total Large-Scale Manufacturing: 1978–88

Years	Employment share (%)	Value added (%)	Public sector share in total industrial investment (%)
1978/9	14.47	7.12	72.74
1979/80	14.34	14.55	65.25
1980/1	15.24	12.27	58.01
1981/2	16.15	13.28	52.03
1982/3	14.82	13.90	48.29
1983/4	16.36	11.81	44.56
1984/5	–	–	31.38
1985/6	–	–	30.68
1986/7	–	–	21.64
1987/8			17.85

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 117.

7.1.4 Deregulation and Liberalization

The Sixth Five-Year Plan (1983–8) marks the beginning of the process of deregulation and liberalization, which was carried out with much greater force after 1988 when Pakistan's economy became completely subservient to IMF and World Bank directives. The Sixth Five-Year Plan is seen as a departure from the government's earlier policies on industry, and 'it was for the first time that the emphasis moved from purely one of sectoral investment planning to one which also incorporated incentives and institutional reforms to enhance the efficiency of the industrial sector'.[31] Export-led industrialization was mentioned for the first time as a policy goal, and there was an emphasis on the broadening of manufactured exports towards higher value-added items.

Amongst the more important initiatives in pursuit of deregulation and liberalization in this period were the following:

> An increase in the investment sanction limit; drastic reduction in the list of specified industries (which require government sanction); reduction of tariffs on a number of raw materials, intermediate and capital goods; introduction of a three-year liberal trade policy; and upgrading of an Industrial Incentives Reform Cell (IIRC) into a Tariff Commission in 1989 to make recommendations on fiscal anomalies and effective protection.
>
> A series of measures . . . introduced to deregulate industrial operations in the cement, oil-seeds and fertilizer industries. Private investment . . . permitted in cement production and State-owned enterprises . . . allowed to vary their prices. Subsidies . . . substantially reduced and cement imports permitted. A similar package of de-regulation and reform was adopted for the oil-seeds sector and a major divesture programme was initiated by the public ghee corporation.[32]

Along with these measures, important steps were taken to liberalize and encourage foreign trade. Prior to 1983, imports were considered to be either 'free' or 'tied', and goods that were on neither of the two lists, were banned. In 1983 this system was changed and a negative list was introduced, where everything not on that list was now importable. There was also a replacement of quantitative restrictions (non-tariff barriers) by tariffs, which according to the Asian Development Bank was a 'significant development since in Pakistan quantitative restrictions have been a more important source of protection than tariffs'.[33] To encourage exports, manufactured exports were given rebates, and exporters were given import facilities, income tax concessions, and finance at concessionary rates.

All the major works on the Zia period—Asad Sayeed, the Asian Development Bank, the Institute for Developing Economies and S. N. H. Naqvi and Khwaja Sarmad—are agreed:

> Perhaps the most important and far reaching economic decision taken by the government was

to remove the fixed peg of the Rupee to the Dollar by introducing a managed float of the currency in 1982. As a result between 1982 and 1987–88 the Rupee was devalued by 38.5%, with an average devaluation of 7.7% per annum. While there were other macro considerations which dictated the decision to move away from the peg, its impact on industrial decisions to invest and produce was central. The biggest impact was expected to come in export performance. Conventional wisdom has it that Pakistan's export performance has been sluggish because of an overvalued exchange rate. The overvalued exchange rate, it is argued, discriminates against exports not only in capturing larger world market shares but [also in] the implicit protection it accords to manufactured goods at home which inhibits the direction of resources into export industries. Correcting for the exchange rate was seen as the [most] important step in devising an incentive structure geared towards exports.

> Devaluation was also expected to perform an important import substitutive function. Devaluation will enhance prices of imported capital and intermediate goods and will thus induce backward linkages for producer goods industries. Thus the decision was also consistent with the industrial policy priorities of the government as outlined above.[34]

The World Bank, not surprisingly, was particularly happy with the results of the deregulation and liberalization policies of the Sixth Plan. It calculated that the 'private sector's share in total fixed investment increased from 38 per cent in FY83 [1982/3] to 42 per cent in FY88 [1987/8] and in the manufacturing sector its share in investment rose from 51 per cent to 83 per cent'.[35] In a report published earlier, in 1988, the World Bank argues as follows:

> Industrial growth has been encouraged by an improvement in the industrial policy environment for private sector initiative, in accord with Sixth Plan objectives. The composition of industrial investment has shifted heavily toward the private sector. Private industrial investment expanded by almost 23% p.a. in real terms during the Plan period, as against a 7% annual increase in total industrial investment. In total, over 72% of total industrial investment during FY84–87 was contributed by the private sector. The restriction that public manufacturing investment be limited to the completion of ongoing projects and to rehabilitation of existing plants contributed to this outcome.[36]

7.1.5 Causes of High Growth and the Success of the Zia Regime

The fact that General Zia ruled Pakistan for more than eleven years surprised almost all observers. In July 1977, when he took over from Bhutto, Zia came across as an inexperienced, bumbling General who, it seemed, either would not be able to hold on to power, or would willingly transfer power to politicians as he kept promising. No one at that time could have envisaged the fact that General Zia would emerge as Pakistan's longest ruler. Moreover, the only way power was transferred away from Zia to another head of state was through his death in an air crash. The political reasons why he managed to outlast and outwit the opposition have been documented by, amongst others, Omar Noman, Jonathan Addleton and Asad Sayeed[37] (see also Chapter 22 of this book). This chapter only highlights the reasons why the economy performed as well as it did and how a booming economy helped neutralize all political opposition against the government. While there were many political and human rights grounds for the protests against Zia which continued all through his rule, there were few economic justifications for opposition.

Again, all the major authors cited in this chapter are agreed about the causes of a high-growth economy under Zia. The Institute of Developing Economies study summarizes these issues as follows:

> On the whole the manufacturing sector in Pakistan has recorded impressive growth rates during the 1977–88 period. As we have attempted to show the principle reason for this performance has been a result of two important phenomena:
>
> i) the coming on stream of the public sector provided the requisite diversity in the manufacturing sector. This resulted in both the once and for all gains that such large investments are expected to bring in and secondly in the linkage effects that it created.
> ii) the revival of confidence in the private sector to invest in industry once again after the brief interlude of the Bhutto regime. The spheres for private industrial investment that were charted out by the Bhutto regime, i.e. the consumer goods sector and the picking up of linkage effects that the public sector would create, reached fruition in the period under review.
>
> The underlying reason for high rates of growth and investment for growth in output was buoyant demand in the economy as a whole. Because of the remittances from the Gulf and a growing agricultural and services sector consumption demand increased. Investment demand, on the other hand, was enhanced by high resource inflows from the international community, particularly the US, because of Pakistan's strategic role in the Afghan war.[38]

Nawab Haider Naqvi and Khwaja Sarmad believe that the high growth rate of GDP which averaged 7 per cent per annum between 1978 and 1986 was due to a strong expansion in manufacturing led by a booming domestic market (due to remittances and the income from illegal trade, which increased significantly following the Afghan crisis) and the utilization of excess capacity'.[39] Workers' remittances had peaked at $3 billion in 1982/3, and a steady

flow of official capital such as long-term loans and grants, amounting to an 'annual average of more than one billion US dollars enabled the government to finance its way out of the difficult situation created by the deteriorating terms of trade',[40] and helped maintain macroeconomic stability as well as promoting a high growth rate of GDP. During the Fifth Five-Year Plan (1978–83), according to Robert Laporte and Muzaffar Ahmad, the '*yearly average* of foreign aid committed to Pakistan was $1.45 billion, up from the yearly average of $871 million during the Non-Plan period 1970–78'.[41] This annual average of foreign aid committed to Pakistan during the Sixth Five-Year Plan (1983–8), rose to as much as $2.29 billion.[42]

Asad Sayeed shows that while the contribution of foreign resource inflows was an important source of assistance to the Zia regime and helped finance industrial investment, interestingly, its share in total investment declined to almost half its share of 1965–70, and to one-sixth of the heyday of the Ayub period (1960–5) when foreign assistance was a critical factor, resulting in very high rates of growth.[43] Foreign resource inflows are yet another similarity between the Zia and Ayub eras, where external sources helped fund Pakistan's economic development programme. Under Ayub, it was US aid that played the most critical role, while under Zia both US aid, following the invasion of Afghanistan by the Soviet Union, and remittances by Pakistani workers contributed very significantly. In some ways, while the 'bad luck' factor may have contributed to the below-par performance of the Bhutto regime, a 'good luck' element, particularly the Soviet invasion of Afghanistan and high Gulf remittances, helped General Zia's economy considerably, and helped prolong his rule.

However, such a high dependence on external assistance and on extraneous sources meant that when foreign inflows ceased, so would economic development. This was most noticeable under the Ayub regime, but also became a factor in the later period of General Zia's rule. S. N. H. Naqvi and Khwaja Sarmad write:

> The outstanding feature of this period [1978–81] is the rise in remittances, which pushed up the national saving rate. The average share of investment in the GDP rose to 20 per cent in 1977, and was high by historical standards. The growth in investment was due to an increase in public investment in the social and economic infrastructure. The investment in public enterprise remained low, and so did private investment. Public investment increased to an average of 11.6 per cent of the GDP despite the relative decline in external capital to the public sector. This, however, did not alter the public sector's position as the largest recipient of foreign capital. The high level of public investment was financed mainly from household savings (net resource).[44]

While there seems to be agreement that the Zia regime produced high growth, two of the studies cited above have argued that much of what we have seen 'cloaked' the inefficiencies of the economic regime and that it is necessary to go beyond mere appearances and aggregated growth rates. The Institute of Developing Economies in its study argues as follows:

> The relevant question in the context of this study is the extent to which the government's industrial policy, as revealed in its Five-Year Plans and the Industrial Policy Statement, contributed to this growth. The evidence suggests that growth occurred, not *because* of the specific incentives provided in the industrial policy of the government but *in spite* of it. The outline of industrial policy . . . shows that the cornerstone of government policy was to move towards the higher stages of import substitution (through giving priority to technology-intensive and non-consumer goods manufactures), export enhancement (through increasing the value-added in manufacturing exports and export-led growth) and enhancing efficiency in the manufacturing sector. Given the evidence that we have presented in this section, the goal of import substitution in the intermediate and capital goods sector remained unfulfilled. Although, growth in exports increased the contribution of value-added exports and the composition of manufactured exports remained virtually unchanged through the decade. We also tentatively conclude that the productivity performance was also below par.
>
> *In that case the only achievement of the government was to lure the private sector back into industrial activity. Other than that, it was fortuitous circumstances* (the gestation of public sector projects and the international situation) which was responsible for the above average performance of Pakistan's manufacturing sector.[45]

Asad Sayeed is less charitable in his criticism of the cloaked inefficiencies, and concludes his evaluation of Zia's industrial policy in the following manner:

> The 1978–88 period is unique in Pakistan's economic history for exhibiting high output growth without corresponding improvements in the efficiency of factor use in the manufacturing sector. We saw that much of this growth in output was financed by foreign remittances and aid flows coming into the country. The inefficient use of these resources meant that *the country squandered the windfall gains that it received as a result of favourable exogenous conditions.*
>
> In general, the industrial policy structure of the period was not much different from that pursued in countries which performed markedly better than Pakistan, or for that matter from that which prevailed in the high productivity period of the 1960s. Yet, we also saw that in many cases industrial policy was either not implemented, or the policy structure in some cases was not amenable to productivity growth. The existence of smuggling, the precipitous increase in the number of sick industries, irregularities with the licensing procedures, etc. *pointed towards a failure*

> *in the implementation of policy during this time.* We also saw that policies were not altered even when it was abundantly clear that they were harmful for growth and productivity. In particular, the existence of negative ERPs [effective rates of protection] for certain industries, the regulatory regime of the period and the lack of incentives for value addition in the textile sector were identified as important policy errors.[46]

7.2 The Age of Structural Adjustment: 1988 Onwards

7.2.1 The Principles of the Programme

The history and political and economic background of the role that the IMF and World Bank began to play in Pakistan's economy after 1988 are discussed in Part VI of this book. The present section only examines the relevance of the Structural Adjustment Programme (SAP) to the industrial sector.

The Seventh Five-Year Plan (1988–93) was commissioned at the same time as the IMF/World Bank induced conditionality was accepted by the government in the guise of a Structural Adjustment Programme. The plan had set ambitious targets for overall reforms in the industrial sector, and included further deregulation, privatization, tariff reform, and regulation of foreign investment. As far as the three-year agreement (1988–91) with the IMF was concerned, the industrial policy outlined in the letter of interest committed the Government of Pakistan to the following:

- i) limiting the list of specified industries;
- ii) deregulating business decisions;
- iii) raising the investment sanctioning limit annually [it was to be raised from Rs. 700 million in 1988 to Rs. 1 billion in 1989];
- iv) phasing out industrial location policies over a three-year period and provision of infrastructural services at prices that reflect economic costs;
- v) divesting the shares of public sector companies to the private sector;
- vi) instituting a corporate rationalization programme to enhance efficiency in the remaining, i.e. non-divested, public enterprises;
- vii) considering a realistic trade regime as a primary investment or structural adjustment effort;
- viii) enhancing export incentives;
- ix) reducing the level of protection accorded to different industries;
- x) reducing the list of restricted import items as well as those subject to quantitative restrictions;
- xi) achieving a tariff range of 0 to 100 per cent by 1st July 1990; and
- xii) phasing out all tariff exemptions by 1990/91 except duty drawback for exporters, exemptions for import of capital equipment in key industries and reasonable baggage allowances.

In addition to the industry-specific recommendations, the following prescriptions of the IMF's macroeconomic recipe have a direct impact on industrial development in Pakistan.

- i) an increase in the level of indirect taxation (in the form of a generalized sales tax) by July 1990;
- ii) withdrawal of subsidies on gas, electricity, telephones, and fertilizers;
- iii) an increase in producer prices of major crops (wheat, cotton, sugar cane, rice, and oil seeds) and in the prices of petroleum products;
- iv) a 12.5 per cent reduction in the public sector development programme during the agreement period (1989–1991); and
- v) restriction on government borrowing and credit allocation to the private sector.[47]

The World Bank, in its review of the programme of 1988–91, felt that the economy 'responded well to these policy reforms. Progress in implementing structural reforms to promote private sector activity has been exceptional during the last four years, despite three changes in government during this period.'[48] The large-scale manufacturing sector managed an impressive 7.4 per cent in 1991/2 due essentially to the rapid expansion of cotton manufacture. The World Bank considered Pakistan to have achieved an 'excellent growth performance'.

A major emphasis of the Structural Adjustment Programme was on the enhancement of growth by encouraging the private sector, which was supposed to take a lead role. Amongst the investment and industrial policies followed was a 'forceful' programme of liberalizing the economy from government control. Furthermore,

> not only was sanctioning of private investment and import licensing abolished, but also a number of other regulatory restrictions (including registration of technical and foreign loan agreements, procedures for employment of foreign workers, etc.) were also removed. Areas of investment previously reserved for the public sector were opened to the private sector, including power generation, commercial and development banking, and air and sea transport. [Also], it initiated the privatization of some 105 manufacturing units and began to take steps to expand the privatization programme to the energy and telecommunications subsectors. By November 1992, 67 manufacturing units had been sold and important preparatory steps to privatize the telecoms utility (PTC) and gas utilities were underway. Finally, the Government also provided investment incentives to the private sector. In particular, to promote investment in rural areas, an incentive package, including a five-year income tax holiday, exemptions from customs duty, sales tax and import surcharges, be provided for all industries established in rural areas between 1 December 1990 and 30 June 1995.[49]

According to the World Bank, the consequences of following these policies were as follows (see also Table 7.6):

> Industrial value added grew by 6.3% p.a. during this period. Manufacturing, electricity, and water, which explain most (86%) of this favourable result, expanded by 5.9% and 11.3% p.a. on average, respectively. Large investments in the energy sector led to significant increases in all major energy sources during this period: crude oil grew by 5% p.a., gas by 6% p.a., and electricity by 9% p.a., although power shortages continue to be a significant problem. Construction activity was relatively subdued perhaps reflecting the stagnation in public investment. In manufacturing, cotton industries . . . once again dominated the subsector. However, the strong performance of small-scale manufacturing (which accounts for about one-third of total manufacturing value-added) and non-traditional large scale industries is encouraging.[50]

According to the World Bank's analysis, 'the cornerstone of the Government's adjustment programme is to increase the level and efficiency of private investment and activity by deregulating the economy and promoting competition'[51] (see Box 7.1 for the new rules of credit allocation). There is a very strong emphasis in most Structural Adjustment Programmes on increasing foreign direct investment (FDI) and foreign portfolio investment (see Box 7.2). The Government was urged in 1993 to continue pursuing the private sector agenda aggressively in the coming years, a demand that Pakistan's government was eager to pursue in the next three-year programme of 1993–6 (see Part VI).

While the World Bank and the IMF have concluded that the three-year Structural Adjustment Programmes launched in 1988 and 1993 went rather well—especially in the industrial sector, where the private sector has been the main proponent of the new policies—it is worth ending this section with an evaluation by a neutral party. The Japanese Institute of Developing Economies, comparing actual industrial production with the targets between 1988 and 1992, draws the following conclusions:

Table 7.6
Sectoral Contributions to GDP Growth: 1981–92 (%)

Sectors	Sectoral contributions to GDP growth[a]					
	Average 1981/1988	1988/90	1989/90	1990/1	Prelim. 1991/2	Average 1988–1992
Agriculture	1.07	1.77	0.79	1.31	1.64	1.38
of which:						
Wheat	0.06	0.44	–0.04	0.10	0.01	0.13
Rice	0.00	0.02	0.02	0.05	–0.11	–0.01
Cotton	0.35	–0.06	0.04	0.52	1.23	0.41
Sugar cane	0.00	0.24	–0.10	0.04	–0.08	0.02
Livestock	0.41	0.44	0.46	0.38	0.45	0.44
Mining and quarrying	0.04	0.01	0.05	0.06	0.02	0.04
Manufacturing	1.44	0.67	1.00	1.11	1.36	1.03
Large-scale	1.09	0.29	0.60	0.70	0.94	0.63
Food and beverages	0.15	0.03	0.04	0.03	0.20	0.08
Cotton related	0.14	0.09	0.28	0.26	0.38	0.25
Fertilizers	0.09	0.02	0.03	–0.02	–0.04	–0.01
Petroleum products	0.04	–0.03	0.03	0.09	0.00	0.02
Cement	0.02	0.00	0.01	0.01	0.01	0.01
Pig-iron	0.05	–0.02	–0.01	0.03	0.01	0.00
Automobiles	0.05	0.03	0.04	0.00	0.03	0.02
Others	0.57	0.16	0.17	0.31	0.35	0.25
Small-scale	0.36	0.38	0.40	0.41	0.42	0.40
Construction	0.22	0.10	0.13	0.24	0.25	0.18
Electricity, gas, and water	0.21	0.37	0.44	0.34	0.24	0.35
Transport and communication	0.73	–0.41	0.61	0.52	0.66	0.35
Commerce	1.26	0.87	0.58	0.91	1.25	0.90
Financial institutions and insurance	0.21	0.08	0.09	0.08	0.04	0.07
Public administration and defence	0.40	0.57	0.20	0.24	0.13	0.28
Other services	0.69	0.77	0.78	0.78	0.79	0.78
GDP (at factor cost)	6.51	4.79	4.67	5.59	6.38	5.35

[a]Sectoral contributions to growth rate are computed by weighing the sectoral growth rates by the previous year's sectoral share (in GDP).
Source: World Bank, *Pakistan: Country Economic Memorandum FY93: Progress Under the Adjustment Programme*, Report No. 11590-Pak (Washington DC: World Bank, 1993), 5.

Box 7.1

Credit Allocation for Industry and the New Rules of the Structural Adjustment Programmes

Credit plays a critical role in investment, as the Institute of Developing Economies study shows:

> The allocation and cost of credit to industrial sectors is a key tool for implementing industrial policy. It has been used extensively in countries with active state interventionist policies, to ensure that targeted industries are provided with adequate input of capital to meet their investment and working capital requirements. Multilateral financial institutions, under the influence of neo-classical thinking, have been opposed to the use of targeted and concessional financing, on the grounds that it distorts capital allocation and causes financial repression. Through their structural adjustment loans, they have brought considerable pressure to bear upon the Pakistani planners to phase out concessional credit. The planners, however, are concerned about the effect this would have on the local machinery manufacturing industry and the export sector, which rely heavily on concessional funding. However, to date, no comprehensive analysis of the costs and benefits of concessional financial has been carried out.

Opponents of the scheme point out that while access to export financing has been increasing substantially, it does not seem to have had a corresponding effect on the level of exports, which is primarily determined by competitiveness, quality standards, tariff policy and exchange rate policy. They point out that interest rate subsidies cannot compensate for a lack of competitiveness, poor quality, a discriminatory tariff regime, and an overvalued exchange rate: it merely creates further distortions.

Nevertheless, in an economy where until the recent financial sector reforms, credit was allocated in a detailed manner, through an annual credit plan, access to credit is a vital lifeline. Pakistani industry has always been highly leveraged, relying on debt rather than equity financing for capital investment. First, because it was relatively cheaper on a real post-tax basis, and secondly because it avoided all the legal complications associated with equity flotation. Thus, the volume of credit made available to industrial sectors is a crucial determinant of its output growth.

Source: Institute of Developing Economies, *The Study on Japanese Cooperation in Industrial Policy for Developing Economies: Pakistan* (Tokyo: IDE, 1994), 340.

> The first point revealed by an examination of the data is the extent of variation between targets and achievements, and the number of products that were subject to them. We note, for example, that the variations affect up to 30 products for which data were available and range from a deficit of 75% to an excess of 1013%. The corresponding growth rates also show large variations. The second fact that becomes immediately apparent is the degree to which variations match the difference between revised and original targets for the plan. *It appears that planning in Pakistan is really an ex-post exercise. In other words, as the planners realize that their original targets are not being met, they revise the targets to more closely approximate likely outcomes.* Thus, in 1992, the planners readjusted their targets, in light of the data on actual production as of that year, so that it could be said at the end of the plan period that targets were accomplished. This is really an exercise in self-deception. No attempt, it appears, is made to find causes for variations, or solutions to overcome the problems identified. Objectives are outlined, targets set, and then the planners await, with bated breath, the ultimate outcome! The monitoring of plan outcomes is not done in a periodic and systematic manner.[52]

For further analysis of policies and their consequences under the Structural Adjustment Programme, see Part VI.

7.2.2 Assessing the Impact on the Industrial Sector

Although some analysis takes place in Part VI of this book on the overall impact of the Structural Adjustment Programme, and while we analyse recent trends since the late 1990s to the present in Chapter 18, it is worth our while focusing primarily on the industrial sector since the 1990s in this chapter. Table 7.7 shows how much lower the growth rate of manufacturing was in the 1990s compared to the 1980s, falling from a very impressive 8.21 per cent average annual increase over the decade, to only 4.8 per cent for the average of the 1990s. Moreover, in the last five years of the 1990s, the growth was only 3.22 per cent. In 1996/7 the growth for the industrial sector was *minus* 0.1 per cent, and was only 1.5 per cent in 1999/2000. Clearly, this was a worrying trend at that time. However, in the period after 1999, for the average of the period of the decade of the 2000s (1999/2000–2009/10), we see a huge shift in growth in the manufacturing sector, to a decade average of 7 per cent, clearly a phenomenal growth, the highest in manufacturing since the decade of the 1980s. In fact, there were some years when manufacturing growth in this decade grew by as much as 14 per cent (2003/04) and even higher, 15.5 per cent in the next year, 2004/05. The high average for the decade of the 2000s is even more striking, because towards the end of that decade, towards the end of the Musharraf regime, in 2007/08, and in the years of the People's Party government, the manufacturing growth rate, as well as that of the overall economy, took a sharp nosedive. In fact, in the first year after Musharraf's ouster, in 2008/09,

Box 7.2

The Policy Initiative to Attract Foreign Direct Investment (FDI)

The World Bank documents Pakistan's attempts to attract FDI:

> Since late 1990, the Government in Pakistan has initiated a number of policy and regulatory measures to improve the business environment in general and attract FDI in particular. The requirement for Government approval of foreign investment has been removed and 100 per cent ownership is permitted, with the exception of projects in industries included in the Specified List, which are: (a) arms and ammunition, (b) security printing, currency, and mint, (c) high explosives, and (d) radioactive substances. Foreign investment remains prohibited in the areas of agricultural land, forestry, irrigation, real estate, insurance, health, and related services. In the petroleum subsector, the Government enacted a new Petroleum Policy which is significantly more conductive to foreign investment than previous policy guidelines. Foreign firms can now also engage in export trading activities. Previously, the Provincial Governments had to issue a No Objection Certificate and effectively controlled the physical location of the investment. Now, these governments limit their a-priori approval only to so called negative areas. Furthermore, the elaborate controls that used to be imposed on the transfer of technology have been entirely removed. Technology buyers face no ceilings over the amount of royalties and technical fees they are allowed to pay.
>
> One of the most important measures taken recently by the Government affecting FDI was the liberalization of the foreign exchange regime. Residents and non-resident Pakistanis and foreigners are now allowed to bring in, possess and take out foreign currency, and to open accounts and hold certificates in foreign currency. Foreigners using foreign exchange have now access to the capital market. For example, no permission is required to issue shares of Pakistani companies to foreign investors, unless they belong to industries included in the Specified List. Remittance of principal and dividends from FDI and from portfolio investment made by foreign and non-resident Pakistani investors are allowed without prior permission or clearance from the State Bank of Pakistan (exceptions: foreign airlines, foreign shipping companies, insurance companies).
>
> Export incentives have been introduced or broadened. The highly cumbersome duty-drawback system is being replaced with a scheme whereby 80 per cent of the duty-drawback is paid automatically within three days to the firm, and the remaining 20 per cent is paid within one week after inquiry. Moreover, import policy has been partially liberalized: the average import duty on raw materials was lowered, a large number of quantitative restrictions and non-tariff barriers were removed, and the negative and prohibited lists of imports were reduced. Finally, the 55 per cent income tax rebate on export earnings was changed into a 75 per cent rebate for export of high value-added products, and a 50 per cent rebate for all other products. As in the case of investment incentives, these rebates may not be cost-effective and generally lead to distortions in the incentive structure.
>
> The Government has also enacted an extensive set of investment incentives including tax holidays for projects in rural and underdeveloped areas. Imported machinery not manufactured locally is fully or partially exempted from import duties, depending on whether a project is located in a rural area, underdeveloped areas, or industrial estates. A variety of other fiscal and monetary incentives are offered for projects in selected industries like electronics, tourism, pharmaceutical, dairy farming, mining, engineering, fertilizer, and cement. Experience in other countries generally indicates, however, that these kind of incentives are not cost effective.

Source: World Bank, Pakistan: *Growth Through Adjustment*, Report No. 7118-Pak (Washington DC: World Bank, 1988), 40.

the growth rate for the manufacturing sector was *minus* 3.6 per cent! The manufacturing sector has struggled since then and did so in all the years of the Pakistan People's Party regime from 2008 onwards. There are many reasons why the manufacturing sector and the economy overall, witnessed such a boom in some of the Musharraf years, and why they both collapsed after 2008 or so.

Many of these reasons are explained in detail in Chapter 18 and in Chapter 25, but the main reasons why the manufacturing sector and the economy grew in the decade of the 2000s after the dismal performance of the 1990s were as a consequence of the windfall gains on account of 9/11 and especially, the rescheduling of Pakistan's debt following 9/11. The fall In manufacturing after 2008, came about because of the change, not just from one government to another in Pakistan, but from a transition from a military dictatorship to a democratically elected government and all the consequences related to such a transition. Furthermore, the consequences of the War on Terror brought home very violent repercussions for Pakistan's society and economy, and affected investment and growth. To add to Pakistan's specific problems, was also the global recession which began in 2008, and the phenomenal rise in world oil and food prices. While the People's Party government of 2008–13 inherited difficult global conditions which were not conducive to growth and also had to deal with serious political and terrorist-oriented conditions at home, one cannot deny the fact that its own poor performance and the lack of a vision and clarity, also played a significant role. Many of these issues are discussed further in Chapter 18.

Other trends in the industrial sector in the 1990s and after, only reconfirmed the deteriorating condition of industry in the country. For example, fixed investment, as a percentage of GDP in 2002/3 was only 13.1 per cent, down from 19 per cent

Table 7.7
Key Indicators in the Industrial Sector: 1990–2012

	1980s	1990s	1990–95	1995–2000	2000–03	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12P
Growth rate of manufacturing sector:	8.21	4.8	5.75	3.22	6.97	6.9	14.0	15.5	8.7	8.3	4.8	–3.7	5.2	3.1	3.6

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12P
Fixed investment (% GDP)	17.4	18.5	19.1	17.9	16.9	17.2	16.2	14.7	13.9	14.4	13.9	13.1	15.3	15.0	17.5	20.5	20.9	20.5	16.6	13.8	11.5	10.9
Public investment	8.5	8.7	9.1	8.3	8.2	8.2	6.8	5.2	6.1	6.0	5.5	4.8	4.0	4.0	4.3	4.8	5.6	5.4	4.3	3.6	2.9	3.0
Private investment	8.5	9.8	10.0	9.6	8.7	9.0	9.4	9.6	7.9	8.4	8.4	8.4	11.3	10.9	13.1	15.7	15.4	15.0	12.3	10.2	8.6	7.9
Gross Fixed capital formation (GCFC) Private sector, constant market prices of 2000/01* (Rs. Mn) Large Scale	14,468	14,076	14,448	8,619	9,814	9,289	8,248	5,741	7,293	7,523	10,199	12,844	120,969	115,700	117,147	140,320	142,424	125,001	93,833	77,855	59,131	42,888

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years); State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010* (Karachi: SBP, 2010).
Note: base year changed from 2000–01. P = provisional

in 1992/3, falling gradually and noticeably each year. With the privatization programmes of all governments since 1988, it is not surprising that public investment at 4.5 per cent in 2002/3 was half of what it was in 1988/9. What is more disturbing is that while all governments have been relying on the private sector to lead Pakistan to higher levels of development, private investment as a percentage of GDP, also fell from around 10 per cent in 1992/3 to around 8 per cent after 1998/9. Most startingly the Gross Fixed Capital Formation (GCFC) in the private sector in the large scale-manufacturing sector in 1980/1, in constant prices, fell continuously over the 1990s, by as much as 60 per cent between 1991/2 to 1998/9—see Table 7.7.

After the 1990s, most of these investment and manufacturing indicators improved substantially. In the decade of the 2000s, both total investment and fixed investment grew by rates which were even higher than in the 1980s when a great deal of investment and growth took place. However, what is interesting is that in the 1980s, public investment as a percentage of GDP, was higher (9.2 per cent) than private investment (7.8 per cent), showing the large scale public development made in that decade. *The structure of the economy had shifted markedly*, when despite overall higher investment in the 2000s, it was private sector investment which was the main motor of investment in Pakistan, and was almost three times as much as public investment (12.6 per cent compared to only 4.8 per cent). There has been a continuous drop in public investment since the 1970s where public investment is now less than one-third of what it was on average in the 1970s (3.3 per cent in 2010/11 compared to 10.3 per cent for the 1970s). Private investment in the 1970s was a mere 5.6 per cent for reasons which were explained in the last Chapter. In the 2005–08 period, private investment was above 15 per cent.

This trend marks a very clear shift in the dynamics of investment in Pakistan. The private sector is now the lead sector in investment, unlike for the first four decades of Pakistan's existence. This factor might also explain the very dismal performance of manufacturing and of the economy, more generally, since the collapse of the Musharraf regime and with him, in the economy. Public investment has been falling steadily over the last few decades, down to around 3.3 per cent of GDP in 2010/11. As a consequence, it seems now that growth and investment is now to be lead by the private sector. If this is the case, then it seems that growth and investment in Pakistan will depend on incentives to the private sector and on conditions in which the private sector is willing to invest. Clearly, conditions in Pakistan since 2007, on account of the War on Terror, will not be attractive to the private sector, and only the public sector can provide new investment. This dependence and reliance on only the private sector, when privatization has taken place and the role of the state has diminished, will mean that manufacturing and new investment will tend to be much lower, and more incentive- and condition-specific, and hence more wayward, than had public sector lead growth and manufacturing.

The numbers above reveal the stark reality, that the industrial sector has suffered since the neo-liberal Structural Adjustment Programme was initiated in 1988 and only extraneous and fortuitous circumstances after 9/11, were able

to reverse that trend. Moreover, once the benefits of those factors was lost due to another round of post-9/11 factors, we are back at the same place before 9/11. Many scholars who have looked at this Programme in any detail and have tried to link it with the performance of the economy overall, do not claim with complete certainty as proof that this slowing down in the economy is a *direct cause* of adherence to the adjustment programme—for there are many other reasons as well—but they do clearly and convincingly show *association* and a *clear link, especially with regard to manufacturing and industry.*[53]

We can demonstrate this link and association by looking at numerous policy interventions on account of the Structural Adjustment Programme and their consequences on industrial inputs and performance. For example, if we examine the cost of borrowing—the rate of interest—to borrowers of capital, we will see how reforms in other sectors impact upon the industrial sector. From an average of 12 per cent in 1990, the rate of interest for financing long term industrial investment rose to an average of 20–23 per cent by 1997. The interest rate on working capital also increased to 25–30 per cent in the same period.[54] The rate of interest in Pakistan was a controlled and regulated rate which was kept low—around 6 per cent—in the 1980s, was 'liberalized' (increased) and supposedly made market determined as a consequence of 'reforms' in the financial sector.

Similarly, freeing up of the prices of utilities—let the market decide—forced prices up for gas, electricity, and petroleum inputs, all having an impact on final products. Electricity prices rose by 14.7 per cent per annum between 1991–2001, while gas rose by 10 per cent and the price of petrol was above Rs. 100 in 2012, from Rs. 13 in August 1993. This 'rationalization' of the utility pricing structure has undeniably had an impact on industrial costs and competitiveness. Add to this that tariff rates have fallen drastically from a maximum of 225 per cent in 1986/7 to 25 per cent currently making imported goods cheaper, it is then not surprising that more than 4,000 industrial units were declared 'sick' and overall industrial production has been what it was in the 1990s, and has been after the Musharraf artificial and unsustainable 'boom', which came to an end in 2007—see Box 7.3.

Box 7.3

IMF Conditions Derail Textile Vision 2005

This news item from *Business Today*, 3 June 2001, identifies how the Government's Textile Vision 2005 strategy unveiled with much fanfare in May 2000, came undone as a consequence of IMF conditionality.

'While the government intends to provide soft-term loans to the textile industry, under Textile Vision, the IMF wants elimination of all such credits in future. This will put an end to an ambitious textile export promotion programme envisaged by the sitting government' officials said. Sources in the Ministry of Commerce, say the government and the International Monetary Fund have dissenting views on the provision of concessional credit to the export-oriented textile manufacturers.

'With the advent of World Trade Organization (WTO) agreement and subsequent elimination of quota system by the year 2005, Pakistan's textile manufacturers will be facing enormous challenges to market their products globally, without the availability of soft-term loans both for running finance and export refinancing,' sources said. Another key objective of the vision is to enable the industry to acquire modern technology for value-addition of textile products that can substantially help indigenous textile manufacturers meet upcoming challenges of free-trade beyond the year 2005.

The Ministry of Commerce has envisaged credit at exceptionally low mark-up, and other fiscal incentives, such as speedy refunds of taxes, availability of export finance facility at subsidized rates, and duty free import of textile-related machinery. But the domestic banking sector has, on one hand, refused to lend to the textile industry at very low interest and on the other hand, has enhanced the rate of mark-up on the export refinance scheme, leaving the textile manufacturers high and dry.

Meanwhile, in a bid to meet the tough revenue target, the Central Board of Revenue has neither provided any significant tax relief to the textile sector, nor has it paid billions of rupees in refund to the textile exporters on time. To meet the shortfall in tax revenue during the first half of this fiscal year, CBR withheld refunds of more than Rs. 15 billion, creating a liquidity crisis for the entire export industry in the country, which ultimately slowed down the growth of exports in the later months.

The banks are not in a position to provide adequate credit at exceptionally low mark-up. The textile manufacturers are also not willing to take huge loans at the market-based interest rate, says a source.

After the approval of the Stand-By Arrangement (SBA) by the IMF, Pakistan has started phasing out subsidies to the export industry and all the other sectors of the economy. Consequently, the banks have enhanced the mark-up rate on the export refinance scheme, while by the end of June this year the banks would completely withdraw subsidy on the said scheme.

To the utter dismay of Pakistani textile manufacturers, their arch rivals India and China have already started extending elaborate financial credit and incentives to their indigenous industry. Recently, a delegation of the Indian Textile Machinery Exporters Association, that visited Pakistan, informed that their government was giving a huge subsidy to the textile industry in the form of credit and other fiscal benefits so that the industry could produce quality products at competitive prices.

The Lahore-based exporters, maintained that the abolition of subsidies would serve no purpose but create difficulties for the indigenous industry.

'Instead of blindly pursuing the policies of the IMF, the Government should try to revive the local industry so that the economy could be put back on track,' said the two businessmen. The textile industry has fetched around $550 million additional foreign exchange last fiscal, while during this fiscal, this sector is expected to attract even more through exports. 'The textile sector can double its exports within the next three to four years, provided it is given adequate credit to implement its balancing, modernization, and replacement (BMR) plan,' a Commerce Ministry official said.

Source: *Business Today*, 3 June 2001.

These are just some of the 'reforms' undertaken since 1988 which have had an impact on Pakistan's economy and on the industrial sector—also see Part VI. With the advent of WTO and with increasing competition and globalization, Pakistan's future prospects in the industrial sector seem challenging, if not bleak—see Chapters 8 and 9 as well. We must also hold the governments of General Musharraf and the one which followed it, of the Pakistan People's Party, responsible for creating an energy crisis, especially by the latter government, which has led to a further collapse of the industrial and manufacturing sector, an issue discussed further in Chapter 8 and Chapter 18.

7.3 Summary and Further Reading

7.3.1 Summary

During 1977–88, industrial development regained the momentum that was lost between 1972 and 1977, and growth rates of industry and of the economy returned to the historically high levels of the pre-Bhutto era. For this reason, and also because both Ayub Khan and Zia ul-Haq were military dictators, there are quite a few similarities in the process of development in the periods of their rule. The private sector returned to Pakistan after the Bhutto years and began to play a key role in industrialization.

Zia reaped many rewards that resulted from the initiative of his predecessor, and fortuitous circumstances, too, helped in establishing and maintaining an economy with very high growth. A number of public sector projects came online, and the Middle East boom in this period resulted in workers' remittances of as much as $3 billion in one year easing any strain on the economy. The Soviet invasion of Afghānistan resulted in Pakistan acquiring the (dubious) title of 'frontline state', with military and financial aid, again reminiscent of the Ayub era, flowing into Pakistan. Not only did large-scale production play an increased role as it did under Ayub, but the small-scale sector, due to Bhutto's policies, showed dynamic growth in the Zia period.

After General Zia's death, the democratic transition was matched by a new economic order, and Pakistan entered the world of the Structural Adjustment Programme, under the careful eye of the IMF and World Bank. The eleven years of high growth under Zia clearly unravelled, and the high expectations of the Structural Adjustment Programme were not fulfilled in the 1988–99 period when electoral politics returned to Pakistan. It was only after 9/11, under Pakistan's third military dictator, that growth rates in the industrial sector, in investment, and of the economy picked up. As we argue in Chapter 18, this was only on account of the windfall gain which accrued to the Musharraf regime after 9/11. The other, negative, repercussions of Musharraf's policy after 9/11, were brought home as his regime was coming undone, and growth rates, of the economy, investment, and manufacturing, fell sharply. Changed domestic and international factors also affected Pakistan's economy, but so did the policies of the People's Party government, particularly its inability to deal with the energy crisis—also see Chapter 18.

7.3.2 Further Reading

Probably the most outstanding work on the subject is: Asad Sayeed, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995. Other useful texts include Omar Noman's *The Political Economy of Pakistan, 1947–85* (London: KPI, 1988); Nasim, Anjum, (ed.), *Financing Pakistan's Development in the 1990s* (Oxford: Oxford University Press, 1992); UNIDO: *Pakistan: Towards Industrial Liberalization and Revitalization* (Oxford: Blackwell, 1990); the Institute of Developing Economies' *Study on Japanese Cooperation in Industrial Policy for Developing Economies: Pakistan* (Tokyo: IDE, 1994); S. N. H. Naqvi and Khwaja Sarmad's manuscript, *External Shocks and Domestic Adjustment: Pakistan's Case, 1970–1990* (Islamabad: University Grants Commission, Monograph Series, 1994); Khan, Shahrukh Rafi (ed.), *Fifty Years of Pakistan* (Karachi: Oxford University Press, 1999), and his *Do World Bank and IMF Policies Work?* (London: Macmillan, 1999) are essential reading. Parvez Hasan's, *Pakistan's Economy at the Crossroads: Past Policies and Present Imperatives* (Karachi: Oxford University Press, 1998), Asad Sayeed and Saba Gul Khattack (eds.), *Women's Work and Empowerment Issues in an Era of Economic Liberalization* (Karachi: PILER and SDPI, 2001) and Shahida Wizarat's *The Rise and Fall of Industrial Productivity in Pakistan* (Karachi: Oxford University Press, 2002) are also worth reading. The unpublished doctoral dissertation by Ali Cheema, 'Rent-seeking, Institutional Change and Industrial Performance: The Effect of State Regulation on the Productivity Growth Performance of Pakistan's Spinning Sector 1981–1994', University of Cambridge, 1997, is also an excellent source for looking at the industrial, and particularly textile, sector in a political economy framework. Finally, three earlier reports prepared by the World Bank on changes since 1988 should also be consulted: *Pakistan, Growth Through Adjustment*, Report No. 7118-Pak (Washington DC, 1988); *Pakistan: Medium-term Economic Policy Adjustments*, Report No. 7591-Pak (Washington DC, 1989); and *Pakistan: Country Economic Memorandum FY93: Progress Under the Adjustment Program* Report No. 11590-Pak (Washington DC, 1993).

See also two recent studies for a detailed perspective on Pakistan's manufacturing and industrial sector. The *Final Report of the Panel of Economists: Medium-term Development Imperatives and Strategy for Pakistan*, commissioned and published by the Planning Commission, Government of Pakistan, April 2010, and the extensive study by Abid Burki et al. *Industrial Policy: Its Spatial Aspects and Cluster Development in Pakistan, Volume I, Analysis Report to the Industrial Policy 2010* (Lahore: LUMS, 18 October 2010).

Appendix 7.1

The Emergence of a New Breed of Entrepreneur under Zia

This article by Asad Sayeed tries to compare the change in the nature of entrepreneurs from the time of Ayub Khan to the end of the Zia period.

If the Habibs, the Saigols, the Valikas, Ispahanis, and Fancys were considered role models for budding businessmen during the 1950s and 1960s, today's corporate kingpins like the Lakhanis, the Sharifs, and the Hashwanis have become the idols of aspiring yuppies at the business schools of Karachi and Lahore in the 1980s.

The last decade has seen a significant transformation in the country's industrial élite, as a result of the separation of East Pakistan and the nationalization policy of Zulfikar Ali Bhutto's regime. This is not to say that all the big names from the original '22' have literally gone under. In fact, if one goes by the financial assets listed on the stock exchange some of the industrial giants of the pre-nationalization phase—like the Habibs, the Dawoods, the Saigols, the Crescent group, and the Wazir Alis—continue to occupy prime positions on top of Pakistan's corporate ladder.

But according to most observers of the country's corporate scene, the list of industrial giants would have been quite different if some of the new groups—like the ubiquitous Sharifs of Lahore, the FECTO group, Captain Athar's Schon group, and a horde of other textile empires—had all their companies listed on the exchange. 'I believe that if one was to sum up all the net worth of say, the Ittefaq group, they would certainly be way up among the top 5 industrial giants of the country,' says a veteran observer of Pakistan's corporate scene. He goes on to say that 'the big groups in Pakistan have always held way above the majority of shareholdings required for controlling the management, and with liberal credit available from DFIs, it does not make any real difference to them if they do not seek equity from the stock market.' It seems that the new industrialists have learnt from the tumultuous '70s when Zulfikar Ali Bhutto used the 'big 22' phenomenon as a major rallying point to come into power and subsequently nationalized many of the big industries.

However, there are some other important ways also in which the new guard is clearly distinct from the old. For one thing, almost all of the big entrepreneurs of the '80s have adopted aggressive marketing and advertising strategies. But while this high-profile corporate strategy may apply to their marketing activities, as mentioned earlier, the opposite is true about their financial standing. While it was a matter of pride for the older industrial giants to be listed on the exclusive club of the 'big 22', their lifestyles were conversely, far less ostentatious than the conspicuous consumption pattern that has become characteristic of the more nouveau brand of financial tycoons today. Financial savvy now amounts to carefully protecting all the particulars of one's financial worth, especially if some of the wealth has been fashionably fuelled through this decade's business obsession of under and over-invoicing.

Another legacy of the Bhutto years—the labour laws—have made the mode of operation of Pakistan's industrial sector in the 1980s different from that of their predecessors. The introduction of the old-age benefit scheme, social security, medical cover, and a limitation on the discretion of the employers to hire and fire, has increased the costs of the employers by considerable proportions.

While the corporate generation of the 1960s could happily amass fortunes without being saddled with such 'oppressive' legislation, the new lot has dealt with these laws in quite an ingenious manner. Instead of hiring their labour force on a permanent basis, the industrial sector of the 1980s has resorted to the now popular practice of hiring it on a contract basis. By doing this, they manage to sidestep another major impediment in the way of accumulating huge profits.

However, boasting palatial houses or gleaming limousines these days is not just the hallmark of the business magnates aspiring to become socially indispensable, or of the powder-kings with not enough places to spend their highly liquid drug money. These are also some of the crasser symbols of bourgeois bounty flashed around by a whole new breed of export-led trade magnates. Indeed, it might even be true to say that the 1980s has seen the proliferation of a new class of entrepreneurs who can match their big brothers in business in terms of conspicuous consumption. These 'businessmen' are mostly exporters of value-added goods like garments, leather products, rugs, and other items which have an exotic appeal in the western world and Japan.

These exporters—with leading names like Ilyas Malik, Mohammed Saeed, Mohammed Hussain, Khalid Javaid, S. Mohammad Din, Aziz Brothers, and Haji Abdul Latif—have grown and prospered partly as a result of changing governmental priorities, like the devaluation of the rupee. In particular, they have been quick to reap profits from concessions like the very liberal export policy with massive rebates for value-added exports and, like their counterparts in big industries, they have also extorted huge profits by cutting down on labour costs. Instead of relying on the traditional factory-oriented method of production, many exporters have gone for sub-contracting their production to the small power and handlooms, tanneries, and weaving units in the informal sector.

While, on the one hand, this arrangement has made it possible for these exporters to keep their overhead costs low, on the other, it has effectively kept the workforce out of the ambit of labour laws. Thus, with their fixed assets working out as almost negligible on paper, they have been able to make an average profit, which ranges from 400 to 700 per cent per unit of exports.

But despite these differences in the two different generations of corporate élites, it is not entirely wrong to say that they have essentially made it big by riding on the back of the country's bureaucracy.

Most observers of the first industrial boom assert that the infamous 22 families of the 1960s were more a product of state patronage, rather than that of any intrinsic entrepreneurial

genius. Which leads one to wonder if the new business brass has also made it big by accumulating a large share of their booty through the assiduous cultivation of the bureaucracy—who are notorious for not being averse to scratching others' backs if theirs are kept well groomed. Certainly, there can be no denying that the role of the country's establishment in the concentration of industrial assets has remained almost as significant as it was during the industrial boom of the 1960s. If at that point during the 'decade of development', the nascent industrial class of the country was provided easy capital through state-owned financial houses like the PIDC, PICIC, and ICP, the new breed have not exactly been starved of liberal loan windows through nationalized banks and the many DFIs which have been created over the last 15 years (NDFC, BEL, etc.). Similarly, the famous bonus voucher scheme of the 1960s and the overvalued rupee—mechanisms for easing the import of raw materials and export of finished products have taken on the guise of excise and export tax rebates, and import of capital equipment at lower duties. Apart from obtaining these concessions which are general to the industrial sector, big business has essentially thrived by maintaining a close rapport with the top echelons of the bureaucracy—an arrangement which has occasionally been disturbed during the brief interludes of parliamentary democracy in the country.

Another similarity between the élites of the two different eras is that the big industrial conglomerates have backed their industrial and personal assets by floating insurance companies and banks. After the nationalization of all banks and the major insurance companies during the Bhutto era, it took some time for the new groups to commit so much capital to venture in the financial market. But despite memories of the Bhutto squeeze, over the last 10 years almost all the big groups—the Habibs, the Dawoods, the Adamjees from the old lot, and Hashwani, Lakhani, Shirazi, and Firdous groups—have managed to set up insurance companies or modarrabas. The Crescent group is the first which has recently launched its own investment bank.

In terms of industries again, there seems to be little difference in the product mix of the two eras. Like in the past, most of the industries are essentially textile based. Some of the new names have, however, distinguished themselves by venturing heavily into areas like hoteliering (Hashwanis), steel (Sharifs), auto assembly and light engineering (the Atlas and Sony groups).

The picture that emerges out of the present set-up of corporate activity then, is that it continues to be essentially patronized by the state, which not only supports this group, but also turns a blind eye to its numerous illicit practices.

Since the onset of parliamentary democracy in 1985, however, many politicians have been going into industry in a big way—with some leading names like the Saifullahs, Zarri Sarfaraz, and the late Mohsin Siddiqi. And if the present trend continues, one wouldn't be too far off the mark in conjecturing if the '90s is going to see the new breed of politicians-turned-industrialists pushing out the present tycoons to gain a higher position near the top of the corporate ladder.

Certainly, if one is to go by the business community's recent protest marches and convention jamborees, which embodied its threat to boycott government revenues and withdraw advertisements from the electronic media, it is becoming increasingly clear that they are not exactly going to lie low while the feudal politicians sweep away the fruits of their financial standing. There is little doubt in any business observer's mind that, given the present aggressive posture of the business community, it seems that this time they will pre-empt the traditional politicians' move to keep the reins of power in their hands by carving out a political niche for themselves.

Source: *The Herald*, June 1990.

Notes

1. For one of the most outstanding works on Pakistan, a work that compares the political and economic similarities and differences of the Ayub era with that General Zia ul-Haq's eleven years, see Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', Unpublished PhD dissertation, University of Cambridge, 1995.
   A work which throws new light on the Zia era, see Hasan, Pervez, *Pakistan's Economy at the Crossroads: Past Policies and Present Imperatives,* (Karachi: Oxford University Press, 1998).
2. However, the military has been an active player on the political scene both at the national level and, more overtly, in Karachi. See Zaidi, S. Akbar, 'The Roots of the Crisis', *The Herald*, Karachi, August 1992. Also see, the articles in, Zaidi, S. Akbar (ed.), *Continuity and Change: The Socio-political and Institutional Dynamics in Pakistan (Karachi:* City Press, 2003).
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8 Key Issues in Industry in Pakistan

The previous two chapters have given a chronological account of developments in the industrial sector in Pakistan, showing how the differing perspectives of different regimes have influenced industrial and economic growth. This chapter looks at contemporary issues in the industrial sector, including privatization, the textile sector and a host of others, especially energy shortfalls and implications for the industrial sector. Many of the issues in the industrial sector today have their roots in policies adopted many years ago, so much so, that some analysts and experts blame the problems of today on key decisions of yesteryear.

8.1 Numbers and Trends in Industry

The phenomenal growth rate experienced in the industrial sector in Pakistan in the early 1950s took place, from an almost non-existent base, where the growth rate of the industrial sector was doubling itself every few years. The extraordinary growth rates of over 20 per cent between 1950 and 1955 in large-scale manufacturing were achieved primarily because very little existed to start with and, hence, any investment and production, no matter how little, would register impressive gains. Only in the early 1960s did large-scale manufacturing come close to the extraordinary period of the early and mid-1950s. Nevertheless, overall manufacturing did manage to produce a growth rate of close to 10 per cent on average throughout the 1960s (Table 8.1), followed by a substantial reduction in the 1970s, the reasons for which were discussed in the previous chapters. The 1980s once again saw a return to a very impressive annual average growth in manufacturing of 8.21 per cent, a fact which received much recognition by international agencies and independent analysts and scholars (see Chapter 7). The roller-coaster, boom/bust, trend of industrial and manufacturing growth, was witnessed again in the 1990s, when growth fell after the 1980s, to be revived again after 9/11, and to fall again after 2007 for a host of reasons discussed in the previous chapter.

A trend which is striking for its monotony is that exhibited by the small-scale sector. The first few years, 1950 to 1962, show a consistent trend of 2.3 per cent annual growth, followed by a growth rate of 2.9 per cent over the next eight years, with the Bhutto period registering an annual growth rate of 7.3 per cent. From 1977 until the 1990s, we witness a consistent trend of 8.4 per cent; from the 1990s this trend rate falls to another consistent 5.3 per cent, following which after some variation, the growth rate of the small-scale sector stays at 7.5 per cent from 2000–12. This trend seems too consistent for it to be of any real substance. In fact, the growth rate for the small-scale sector is not calculated, as it is for the large-scale sector, and is merely imputed or assumed. Every few years, a readjustment in the annual growth rate is made to reflect a more realistic trend. However, as discussed in section 8.2 the small-scale and informal sector is much more dynamic and productive than the government's figures

Table 8.1
Growth Rates in Manufacturing: 1950–2012 (% Increase at Constant Factor Cost)

Sector	1950–1959	1960–1969	1970–1979	1980–1989	1990–1999	2000–2009	2010–2012P
Industrial Sector	8.9	9.7	6.6	8.2	4.7	5.3	–0.6
Mining & Quarrying	10.5	8.4	4.8	9.9	3.3	17.8	1.0
Manufacturing	8.3	9.0	5.6	8.7	4.3	7.0	3.9
Large-Scale	17.2	12.3	5.1	8.8	4.0	7.3	2.4
Small-Scale	2.3	2.8	7.1	8.4	5.2	7.5	7.5
Slaughtering	–	–	–	–	–	4.3	4.4
Construction	11.4	12.2	6.6	5.5	2.4	3.7	4.9
Electricity and Gas Distribution	10.8	14.6	23.7	9.9	9.4	0.1	–2.8

P = Provisional
Source: State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010*.
Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

show, and in fact, with the large-scale manufacturing sector stalling or even failing, it might just be the backbone of what constitutes manufacturing and industry in Pakistan. Moreover, since this estimate for the small-scale industrial sector is on the low side, this implies that so too would be the figure for overall manufacturing, which is based on both large- and small-scale industry. Furthermore, we argue in the next section that not only is the small-scale sector more dynamic on its own, but many activities previously undertaken in the large-scale sector have shifted to the small-scale sector—textiles in particular. The implications of this are that, unless a correct annual estimate of the small-scale sector is made, the growth rate reported for the overall manufacturing sector will always be on the low side. In fact, as the small-scale sector prospers, the extent of error in the sum for overall manufacturing will increase unless proper figures are made available.

Like manufacturing growth, which has seen some important fluctuations, the growth rates of the mining and quarrying, construction, and electricity and gas sectors have been equally volatile. Construction, in particular, has experienced huge growth in one year, followed by negative growth in the very next year. This fluctuation in construction could be due to the commissioning of large projects in one year followed by fewer or no projects the following year. Dams, power plants, and other large public (and now private) sector projects would show huge investments for one or two years in a row, followed, not surprisingly, by lower or even negative growth rates. For example, in 1960/1 the growth rate of construction over the previous year was an astronomical 43.3 per cent, followed by –2.6 per cent in the subsequent year. From 1977 onwards, and especially since the mid-1980s, the annual growth in construction was positive, and the extent of fluctuation was small. In fact, for all the sectors, the extent of fluctuation decreased after about the mid-1970s. However, fluctuations in the growth of the construction sector became particularly volatile in the 2000–12 period growing by 56 or 59 per cent in one year, to register a negative growth of 26 per cent a year or so later. The construction sector saw a growth of more than 10 per cent in 2005/06 and 2007/08, but –8.6 per cent in 2010/11, with annual growth rates of –10.7 per cent in 2003/04 and –11.2 per cent in 2008/09.

Gross fixed capital formation (GFCF) is the value of capital stock at a particular time. In Table 8.2 (Panel a) the GFCF is presented for a number of years in current prices, and so is not strictly comparable. GFCF can double over a period of time, simply if inflation doubles. However, we can compare the distribution between the private, public, and government sectors. The table shows, as has been argued in previous chapters, that the private sector led growth in industry and the economy through much of the 1960s and again in the 1980s. The public sector dominated in the 1970s and the role of government also increased in the same period. However, since the 1980s, the private sector has begun to dominate GFCF and has increased its role to around three-fourths of the total. It is probable that, with further privatization and the involvement of the private sector in areas which were once the exclusive terrain of the public sector, in future years the role and contribution of the private sector in the economy and in GFCF will grow at the expense of the public sector.

The lower panel of Table 8.2 shows the contribution of both the public and private sectors to GFCF. The shift towards the private sector in most fields is quite noticeable, mainly for the reasons listed above. Large-scale manufacturing now takes place almost exclusively in the private sector as does small-scale manufacturing, and with pro-private sector policies and denationalization, the private sector is playing a much greater role in construction and the electricity and gas sector.

Table 8.3 shows the index of production in manufacturing, while Table 8.4 shows the distribution of production by the main sectors since the early 1970s. Textiles, not surprisingly, dominate, with the food sector also contributing a fairly large share. The pattern since 1969/70 shows that a number of new industries have come online which did not exist in the early and mid-1970s. Most notably, petroleum refining, the ginning, pressing and baling of fibre, transport equipment, industrial chemicals, and a number of other products now contribute a great deal to production. Nevertheless, one-quarter of total industrial production as measured by value addition—Table 8.5—is still textile production, and if we add other cotton-related activity, its share increases further.

A similar picture emerges when we consider the value-added by industry, as Table 8.5 shows that the contribution of textiles increased from about 17 per cent in 1987/8 to 26 per cent of all value-added by industry in 1990/1 where it has remained. The data in Table 8.5, based on the Census of Manufacturing Industries, are available only up to 2005/06 when the last CMI census was held. It is difficult to say what contribution textiles make currently, given the crisis which has engulfed them (see section 8.3 below). Table 8.6 shows the annual growth for some industrial items, and the most marked feature of the table is the phenomenal growth of the 1950s. An equally interesting feature is the very high fluctuation in these items since the 1990s well into the 2000s, where very impressive growth in one year is followed by negative, or low, growth in the next. One important exception is output of cotton yarn, which, although it has fluctuated, has shown impressive growth rates for most of the last decade, although since 2007, like much in the economy and industrial sector, has tumbled rather sharply.

Table 8.7 concludes this section on facts and figures in industry with the average daily employment in major industrial sectors. The striking feature of this table is that, while the overall population of Pakistan almost doubled between 1969 and 1990, the number employed in industry went up by less than half. The reason for this could be that industry became more capital intensive. But this is unlikely, given the output and production trends shown in earlier tables. Another reason could be that the figures listed in Table 8.7, which are for the formal sector only, do not show the trend towards the small-scale/informal sector that took place in the 1980s. Although there may not have been a complete shift of industry from the large scale to the small, larger growth in the small may have captured the increase in the labour force (see section 8.2). It is also possible that, to circumvent labour legislation, employers have preferred to hire part-time, non-unionized, contract workers, rather

Table 8.2
Gross Fixed Capital Formation in Private, Public, and General Government Sectors at Current Market Prices: 1963–2012 (Provisional)

Panel a

	1963/4		1971/2		1976/7		1980/1		1987/8		1994/5		2001/2		2005/6		2010/11		2011/12P	
	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total
Total	5,055		6,813		27,856		42,972		111,266		320,896		476,113		1,565,838		2,069,242		2,255,864	
Private sector	2,870	56.7	3,546	52.0	9,214	33.1	16,874	39.3	51,769	46.5	165,807	51.7	303,574	63.7	1,197,740	76.5	1,549,480	74.9	1,639,510	72.7
Public sector	1,523	30.1	2,350	34.5	12,637	45.4	17,131	39.9	34,886	31.4	96,556	30.0	102,152	21.5	162,022	10.3	148,798	7.2	176,661	7.8
General government	662	13.2	917	13.5	6,004	21.5	8,967	20.8	24,611	22.1	58,553	18.3	70,387	14.8	206,076	13.2	370,964	17.9	439,693	19.5

P = Provisional
Source: State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010.*

Panel b

Gross fixed capital formation in private, public, and general government in industry (1989–2002) Constant Price of 1980/81

(Rs. million)

	1989/90	1990/1	1991/2	1992/3	1993/4	1994/5	1995/6	1996/7	1997/8	1998/9	1999–2000	2000/1	2001/2	2005/6	2010/11	2011/12P
Manufactuing	12,184	13,090	17,859	17,685	18,114	12,071	14,076	14,551	13,110	15,106	14,937	13,997	15,644	326,797	349,418	403,122
Large Scale	9,904	10,544	15,292	14,917	15,133	9,163	10,621	10,847	9,132	10,459	10,347	9,068	10,349	261,023	188,124	177,052
Small Scale	2,280	2,546	2,567	2,768	2,981	2,908	3,449	3,704	3,978	4,647	4,590	4,929	5,295	65,774	161,294	226,070
Construction	1,550	2,714	2,621	1,939	2,323	2,176	2,541	2,154	1,998	1,229	1,200	1,270	1,029	26,106	22,370	29,076
Electricity & Gas	14,176	12,458	14,036	14,266	14,919	23,006	22,638	16,758	17,360	10,523	12,641	17,866	13,825	69,795	131,806	79,885
Transport & Communication	9,283	9,864	11,140	14,265	10,816	9,624	12,897	18,270	15,603	14,212	17,473	15,925	12,044	392,651	224,628	204,190

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).
P = Provisional
Source: State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010* (Islamabad: SBP, 2010).

Table 8.3
Production Index of Manufacturing: 1965–2012 (1980/81 = 100)

Year	Index
1965/66	39.1
1965–70	46.4
1970–75	64.4
1975–80	76.1
1980/81	100.0
1980–85	123.0
1985–90	174.4
1990–95	225.3
1995–2000	258.9
2000–02	303.0
2000–2005	131.7
2005–2010	191.9
2010–2012^{P}	111.9

^{P} = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).
All figures are 5 years average except 2010–2012^{P} (2 years average)
New series: 1999–2000 = 100 and New series: 2005/2006 = 100)

than formal employees. Nevertheless, whatever the cause of the slow growth in employment, all the figures presented in this section show somewhat alarming trends and are cause for serious concern and urgent redress. Unfortunately, more recent data are not available.

8.2 The Small-Scale Manufacturing Sector

Much of the discussion that has taken place in this book with regard to the process of industrialization in Pakistan (Chapters 6 and 7) has revolved almost exclusively around the large-scale manufacturing sector. For most people, the image of industry is one where there are large plants either run by machines, robots, or the computer, or employing hundreds, if not thousands, of workers. Thus, it comes as a surprise to many people when they discover that it is not the large-scale manufacturing sector that provides employment to most workers in the industrial sector, but the small-scale or informal sector[1] that dominates our lives. The small-scale sector is, by far, the more dynamic, exhibiting impressive growth rates in employment, output, and contribution to value-added.

8.2.1 Numbers and Characteristics

Table 8.8 gives us a picture of the informal sector between 1972 and 1986 in urban Pakistan. While there was little change over the fifteen years as a whole, and the share of the informal sector increased only slightly from 69.1 to 72.7 per cent, the actual numbers of those employed have increased by more than 72 per cent, from 2.8 million in 1972 to 4.9 million in 1985 (Table 8.9). This shows an annual increase of 4.3 per cent in employment over this period. During 1976–83, the peak growth of the small-scale sector (see below), the annual real growth rate in employment was as high as 10.3 per cent compared with the *negative 1.1 per cent* for the formal sector in the same period. All recent evidence seems to suggest that this trend has been further accentuated.

A look at Table 8.8 reveals that the informal or small-scale sector has dominated employment in the construction, wholesale and retail trading, hotels, transport, communications, and storage industries in urban Pakistan since at least 1972. However, probably the most interesting feature of the table is the fact that in 1972/3 the formal sector dominated urban employment in manufacturing, but by 1984/5 the informal sector had begun to dominate urban manufacturing in an unprecedented manner. Clearly, given the scale of the small-scale and informal sector, it can 'hardly be termed as marginal to the economy, provider of "employment of the last resort", or as a temporary sponge to absorb new migrants entering the urban labour market and seeking formal sector employment'.[2] The small-scale sector is not only here to stay, but will continue to play an increasing and critical role in a number of areas in the urban economy, and as Chapter 5 showed us, the non-agricultural sector in rural areas which plays such a large part in rural incomes, is also comprised largely, of the small and informal sector.

In the urban manufacturing sector, which mainly concerns us here, *as many as 98 per cent of manufacturing units were small-scale unregistered firms*, and in terms of urban manufacturing employment, 51.4 per cent worked in the informal/small-scale sector, while only 48.6 per cent worked in the formal sector in the 1980s, a balance which must have shifted further towards the small-scale sector since. In 2010, Abid Burki and his colleagues estimated that the 'SMEs constitute 90 per cent of the economic establishments and contribute 30 per cent of GDP and 25 per cent of export earnings, and employ 78 per cent of the non-agricultural labour force'.[3] Tables 8.10 and 8.11 make other comparisons between the formal and small-scale sectors, from which it is clear that much of the capital stock and value-added took place in the large-scale formal manufacturing sector. The annual growth rates over the period 1976–84 (Table 8.12) reveal that in many important areas—employment generation, value-added and growth in capital stock—the small-scale sector has performed far better than the formal, large-scale, manufacturing sector. While the reasons for this growth are discussed below, these same reasons would very strongly suggest that, by most criteria, the small-scale informal sector has outperformed the formal sector in the last twenty years.

With regard to the growth rates in the small-scale sector, it is worth noting the arbitrariness reported by the government in its annual *Economic Survey*. For example, in the 1996/7 survey, the growth rate for the small-scale manufacturing sector for the period 1986/7 to 1996/7 is given as a fixed 8.4 per cent. In the 1999/2000 survey the growth rate is 8.4 per cent from 1990/1 to 1996/7, and then 5.31 from 1996/7 to 1999/2000. However, in the *Economic Survey* of 2002/3, the

Table 8.4
Census of Manufacturing Industries (Rs. m) (Rs. m)

Industry Sector	1969/70	1976/7	1980/1	1987/8	1990/1	2005/06 at producer price	2005/06 at market price	2005/06 at factor cost
All Industries	11,801	30,674	84,288	230,886	374,858	1,103,414	1,204,282	1,023,559
Food products & Beverages	2,420 55	9,587 419	17,532 994	43,791 2,379	62,236 3,092	192,426	216,200	184,498
Tobacco	652	2,207	4,850	9,074	8,767	46,347	53,983	22,618
Textiles	2,964	9,065	14,639	40,361	91,736	269,690	273,194	268,882
Wearing apparel	–	182	608	4,152	7,019	47,216	47,614	48,389
Leather products	300	805	1,195	7,552	10,782	9,816	10,336	9,799
Ginning, pressing, and baling	–	797	8,678	12,095	19,838	-	-	
Wood and wood products	26	61	200	662	792	5,905	6.015	5,871
Furniture and fixtures	18	23	85	305	562	5,670	5,926	5,837
Paper and products	172	461	1,109	2,952	5,576	27,409	30,843	26,052
Printing and publishing	123	332	555	1,947	3,762	3,575	4,047	3,414
Drugs and pharmaceutical products	–	1,001	2,655	7,532	14,102	-		
Chemicals and chemical Products	–	1,614	3,290	11,484	20,186	173,772	184,425	164,098
Other chemical products	937	904	1,995	5,875	8,425	-		
Petroleum refining	–	–	12,505	19,852	30,367	55,699	72,874	48,087
Petroleum and coal products	654	862	481	1,420	2,431	-		
Rubber products and plastic products	75 –	608 109	789 225	2,040 1,340	3,036 1,985	10,600	13,642	10,303
Non metallic mineral products	401	1,000	2,738	11,723	16,034	81,193	93,267	66,644
Iron and steel basic industries	385	1,719	3,309	16,112	21,868	44,687	49,303	40,512
Fabricated metal products	252	637	924	2,109	3,326	8,991	10,685	10,685
Non electrical goods	172	672	1,424	5,562	8,754	15	16	13
Electrical machinery & transport equipment	339 247	1,105 1,383	2,656 2,419	8,668 10,195	12,408 14,529	20,943	22,745	20,713
Measuring, photographic, and optical goods	–	4	57	706	1,056			
Sports and athletic goods*	–	40	89	518	1,489			
Others*	1,609	434	1,287	480	713			
All other industries	–	3,043	–	–	–			

Included in furniture
Source: Government of Pakistan, *Pakistan Economic Survey 1995–96* (Islamabad, 1996), and *Census of Manufacturing Industries 2005–2006*, (Islamabad: Pakistan Bureau of Statistics, 2006).

growth rate from 1992/3 to 2002/3, is a fixed 5.3 per cent. As we have indicated in the previous chapter, the growth rate for the small-scale sector for 2000–12, seems to have been fixed at 7.5 per cent.

Further characteristics of the formal (large) and informal (small-scale and household) sectors can be seen from Tables 8.13 and 8.14. In the formal manufacturing sector in urban areas, the largest number of employed workers are in textiles, as they are in the small-scale and household sector. Fabricated metals account for a substantial share in the small-scale urban manufacturing sector and is ranked second, while food and tobacco are the next largest sector in the formal sector. Table 8.14 shows the distribution of employment within major industries by sectors. The formal sector dominates in the heavier, capital-intensive large-scale industry, while the informal sector dominates in wood and furniture products and jewellery (see Table 8.15). Moreover, the employment elasticity in the small-scale sector is amongst the highest in all the sectors, a fact which is of particular importance when the economy is not doing well and with poverty and unemployment growing (see Table 8.16). Unfortunately, fresh data does not exist which makes it difficult to examine more recent trends. The Final Report of the Panel of Economists estimates, that

> Pakistan's economy has a large presence of small and medium sized establishments, estimated at 3.3 million which contribute 30% of the GDP. . . . They are highly labour-intensive in comparison with the large-scale manufacturing sector with 95% employing less than 5 workers. Presently, there are several SME manufacturing clusters in the country. For example, there is a sanitary-ware cluster located in Gujranwala, a cotton ginning cluster in Rahim Yar Khan, an electrical fittings cluster in Sargodha, a cluster of industries manufacturing light engineering products

Table 8.5
CMI Value of Value-Added: 1987/8 and 1990/1 (Rs. m)

Industry sector	1987/8	1990/1
All industries	74,310	111,006
Food	11,854	15,600
Beverages	1,333	1,568
Tobacco	7,488	7,050
Textiles	12,895	29,251
Wearing apparel	1,167	1,512
Leather and products	991	1,717
Ginning, pressing, and baling	1,091	1,292
Wood and products	254	296
Furniture and fixtures	89	174
Paper and products	828	1,745
Printing and publishing	707	2,513
Drugs and pharmaceutical products	2,802	5,140
Industrial chemicals	5,185	8,713
Other chemical products	2,598	2,838
Petroleum refining	4,379	2,273
Petroleum and coal products	550	1,028
Rubber products	695	1,067
Plastic products	344	607
Non-metallic mineral products	6,480	8,416
Iron and steel basic industries	4,827	6,146
Fabricated metal products	770	956
Non-electrical goods	1,319	2,801
Electrical machinery	2,428	4,561
Transport equipment	2,706	2,875
Measuring, photographic, and optical goods	202	262
Sports and athletic goods	141	421
Others	187	194

Source: Government of Pakistan, *Pakistan Economic Survey 1995–96* (Islamabad, 1996).

in Faisalabad, a wooden furniture cluster in Gujarat, a sports goods and surgical instruments cluster in Sialkot, and the auto parts, PVC pipes, and plastic products cluster in Lahore.[4]

8.2.2 Emergence and Growth

The early development and emergence of the small-scale manufacturing sector in Pakistan, especially in the Punjab, is summarized by Asad Sayeed as follows:

> The tradition of small-scale manufacturing in the Punjab goes back to the middle of the 19th century. But . . . governmental bias against the small-scale sector, low levels of absolute income, a stagnant agrarian economy through the 1950s, and lack of linkages from consumer goods-based import substitution provided little impetus to small-scale industry in the 1950s. The emergence of any significant growth in the sector can be traced back to the beginnings of mechanization in agriculture in the 1961–65 period and the subsequent giant leap experienced in the 1967–70 period with the introduction of green revolution technologies. A survey carried out in 1969 discovered specialized clusters of small-scale industry that had mushroomed in various large and small towns of the Punjab since the beginning of the 1960s. [Others] also report that in 1968 there were 20,000 power looms producing cotton cloth in the non-mill sector in the Punjab.[5]

Khalid Aftab and Eric Rahim, writing about the Punjab, say that there was a sudden emergence of the small-scale sector, 'as if out of nowhere', in the early 1960s. Daska, a small town in central Punjab, had at best a few machine shops in 1961, but by 1965 more than 120 shops were engaged in diesel production. The small-scale agriculturally related engineering industry producing small diesel engines and water pumps, which 'hardly existed' in 1960, employed a labour force of 6,000 by 1965. They argue that 'this aspect of the development assumes even greater importance when it is realized that regular manufacture of these products was unknown in this region of the subcontinent before the 1950s'.[6] They add that 'the emergence of a completely new small-scale sector without any direct government assistance, employing over 6,000 workers in a short period is not, to put it mildly, an everyday occurrence in less developed countries'[7] (see also Appendix 8.1).

Clearly, agricultural growth and the Green Revolution played a critical role in the development of the small-scale industrial, especially agricultural engineering, sector in the Punjab in the 1960s (see Chapters 3–5). In fact, the Green Revolution and its consequences transformed the entire agricultural, industrial, social, and economic structure in major ways (see Chapter 26). One consequence of these developments was the phenomenal growth in the small-scale sector in that period.

Ijaz Nabi analyses the impact of the Green Revolution on the industrial process as follows:

> Demand for farm machinery resulted from the impressive growth of Pakistan's agriculture after the introduction of new dwarf wheat and rice varieties and chemical fertilizers in the 1960s. The agricultural sector grew between 3% and 6% per year, reaching a peak in the late 1960s, and this growth generated considerable demand for agricultural machinery. The most important demand was for tube well engines and water pumps, which ensure timely supply of water and thus facilitate the use of chemical fertilizers. During this period of rising farm incomes, other farm activities such as ploughing and threshing also started to be mechanized. By the late 1970s farmers began to complain about shortages of labour at peak periods of sowing and harvesting. As a result, there was a rapid increase in the use of tractors and tractor-driven threshers, which enabled early harvesting of the winter crop (wheat) and timely sowing of the summer crops (cotton and rice), and which contributed

Table 8.6
Growth of Selected Industrial Items: 1950–2012 (Provisional)

Year	Cotton Yarn	Cotton Cloth	Jute Goods	Veg. Ghee	Cigarettes	Fertilizers	Cement	Soda Ash	Caustic Soda	Sugar
1950s	32.89	27.96	n.a.	22.97	20.38	1.47	8.16	n.a.	n.a.	20.68
1960s	5.63	3.05	n.a.	16.88	10.73	27.49	10.68	12.00	24.35	34.26
1970s	3.37	–5.24	3.38	13.80	4.86	13.19	2.52	2.62	5.04	2.24
1980s	9.96	–1.07	9.48	4.46	–0.36	10.69	8.56	6.89	6.64	14.36
1990s	6.34	4.15	–0.31	0.49	4.49	3.97	2.89	4.90	7.00	5.10
1990/1	14.22	–0.65	1.15	–3.95	–7.41	–2.66	3.66	–1.54	6.08	4.15
1991/2	12.44	5.13	4.13	–2.59	–0.72	–5.50	7.20	26.29	4.46	20.06
1992/3	4.12	5.67	–3.37	13.46	–0.92	14.63	2.76	0.16	0.71	3.23
1993/4	7.44	–3.22	–21.64	–7.45	19.86	20.96	–5.27	0.59	9.46	21.90
1994/5	4.59	2.19	–10.34	5.96	–8.77	–1.27	–2.31	–0.46	4.16	4.33
1995/6	9.16	1.62	3.07	3.09	38.96	8.89	20.90	12.80	17.58	–18.15
1996/7	1.72	1.99	–2.69	–2.59	1.31	–3.53	–0.32	11.66	8.44	–1.77
1997/8	6.76	2.04	38.86	0.70	4.54	–3.15	–1.80	–2.71	–2.12	49.18
1998/9	6.52	13.02	–10.38	7.95	6.98	6.67	2.30	–0.37	4.06	–0.48
1999/2000	8.41	13.73	–1.87	–9.65	–8.92	4.62	–3.33	2.63	17.36	–31.41
2000/1	3.06	12.12	4.56	19.59	24.02	9.21	3.87	–11.30	2.97	21.70
2001/2	5.09	20.09	–8.01	–4.50	–5.05	–0.38	2.70	–1.23	3.85	9.84
2002/3	5.90	2.40	16.90	–3.20	–10.40	2.50	9.20	30.30	9.30	13.50
2003/4	0.70	17.40	8.90	15.10	12.20	9.00	18.60	2.20	14.10	9.10
2004/5	18.20	35.30	0.80	18.00	10.30	7.50	27.10	3.80	10.20	–22.50
2005/6	11.70	–2.30	–0.30	9.90	5.00	4.30	13.50	7.20	6.10	–5.00
2006/7	11.70	8.20	13.00	2.50	2.90	–3.20	22.50	3.70	10.50	19.20
2007/8	2.40	4.00	9.30	–3.60	2.20	2.80	17.60	10.40	2.50	34.20
2008/9	0.00	0.10	6.50	–6.60	12.10	3.00	6.10	0.10	–1.20	–32.60
2009/10	–4.30	–0.70	–22.70	1.30	–13.60	4.10	9.80	12.10	–25.70	–1.80
2010/11	5.46	1.08	–12.30	0.60	0.17	–7.97	–8.33	–7.70	–5.62	32.62
2011/12^{P}	1.13	0.67	5.51	1.53	–3.76	–0.92	2.86	–5.13	–0.04	15.25

Source: Government of Pakistan, *Pakistan Economic Survey*, 2012 (Islamabad: 2012).

> to an overall increase in cropping intensity. Agronomists have called this phenomenon the Thresher Revolution, following the earlier Green Revolution. Demand was also created for haulage machinery such as trolleys for marketing the increased agricultural produce.[8]

For Asad Sayeed, the growth impetus for the small-scale sector in the 1970s occurred as a 'consequence of the convulsions suffered by the large scale sector'[9] under Bhutto. For him, the most important policy in this regard was the pro-labour legislation introduced in 1972. However, for the Asian Development Bank,

> possibly the single most important factor in the increase in the SSI [small-scale industrial] growth rate during the 1970s was the massive devaluation of 1972 and the Government's abandoning the multiple exchange rate as a part of the Export Bonus Scheme. Since the Government allowed LSM [large-scale manufacturing] a subsidy on the import capital and raw materials via artificially cheapened foreign exchange while SSI had to pay the free market rate for foreign exchange to import these items, it was difficult for SSI to compete with LSM in the production of consumer goods or engineering industry products. Devaluation changed this by reducing LSM's cost advantage vis-à-vis imported capital and raw materials. Further, the increase in the effective exchange rate for machinery and equipment was much greater than that for raw materials required for their local manufacture. Thus SSI's competitiveness vis-à-vis imports was also improved. Finally, since SSI goods (e.g. carpets, garments, surgical instruments, sporting goods, etc.) tend to be export-oriented and therefore face price-elastic external demand curves, these industries received a relatively larger boost from the devaluation than did the LSM industries which had become more oriented toward the protected domestic market.[10]

Asad Sayeed agrees with this analysis and argues that it helped the small-scale, export-related industries such as cloth, surgical instruments, and sports goods. He also identifies the impact of the Suzuki car and motorcycle assembly plants

Table 8.7
Average Daily Employment by Major Industry Sectors (in '000)

Industry sector	1969/70	1976/7	1980/1	1987/8	1990/1
All industries	418	457	452	515	622
Food	34	48	52	67	84
Beverages	2	3	4	6	5
Tobacco	11	8	13	9	6
Textiles	198	220	187	171	238
Wearing apparel	–	2	4	12	20
Leather and products	5	4	5	12	15
Ginning, pressing, and baling	13	10	10	–	4
Wood and products	1	2	2	3	3
Furniture and fixtures	2	1	1	2	2
Paper and products	6	8	8	8	8
Printing and publishing	9	9	8	8	8
Drugs and pharmaceutical products	–	7	11	18	18
Industrial chemicals	–	13	13	18	18
Other chemical products	22	7	9	9	9
Petroleum refining	–	2	4	2	2
Petroleum and coal products	2	–	1	2	2
Rubber products	3	10	6	8	8
Plastic products	–	1	2	5	5
Non-metallic mineral products	17	14	12	28	28
Iron and steel basic industries	14	17	18	44	44
Fabricated metal products	–	–	–	12	12
Non-electrical goods	13	15	14	25	25
Electrical machinery	16	17	17	19	19
Transport equipment	17	20	23	19	19
Measuring, photographic, and optical goods	–	–	–	4	4
Sports and athletic goods	–	2	1	8	8
Others	21	11	15	2	2
	–	1	–		

Source: Government of Pakistan, *Pakistan Economic Survey 1995–96* (Islamabad: 1996).

Table 8.8
Estimates of the Share of the Informal Sector in Urban Employment by Industry (%)

Industry	1972/3 (1)	1984/5 (2)	1985/6 (3)
Agriculture	100.0	100.0	100.0
Manufacturing	34.6	70.9	71.1
Construction	79.3	87.9	86.5
Wholesale and retail trade, hotels, etc.	98.9	98.8	98.8
Transport	61.5	74.1	68.0
Finance, insurance, and real estate	67.7	40.9	48.1
Community and social services	55.4	50.5	34.7
All	69.1	75.9	72.7

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 36.

Table 8.9
Estimates of the Size of the Informal Sector in Urban Employment by Industry (in '000 persons)

Industry	1972/3 (1)	1984/5 (2)	1985/6 (3)
Agriculture	376.9	457.2	467.3
Manufacturing	262.8	1,131.5	1,265.0
Construction	227.3	378.9	455.2
Wholesale and retail trade, hotels, etc.	936.1	1,534.0	1,785.9
Transport	212.4	463.9	380.8
Finance, insurance, and real estate	65.3	65.4	97.1
Community and social services	671.0	642.2	513.7
All	2,878.3	4,741.1	4,970.0

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 37.

Table 8.10
Formal and Informal Sector Employment in Urban Sindh and the Punjab: 1984/5 (in '000 persons)

Industry	Formal	Informal	% distribution		Sectoral employment as % of total
			Formal	Informal	
Agriculture	0.0	457.2	0.0	100.0	7.3
Mining	13.0	0.0	100.0	0.0	0.2
Manufacturing	465.1	1,131.5	29.1	70.9	25.6
Electricity, gas, and water	69.4	21.1	75.0	25.0	1.5
Construction	52.0	378.9	12.1	87.9	6.9
Wholesale and retail trade and hotels	18.8	1,534.0	1.2	98.8	24.9
Transport, storage, and communication	162.2	463.9	25.9	74.1	10.0
Financing, insurance, real estate, and business services	94.4	65.4	59.1	40.9	2.6
Community, social, and personal services	630.6	642.2	49.5	50.5	20.4
Other activities	0.0	45.8	0.0	100.0	0.7
Total	1,505.2	4,741.1	24.1	75.9	100.0

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 3.

on the small-scale engineering goods industry through backward linkages from subcontracting.[11]

The import liberalization that followed the 1970s and 1980s is identified as a positive development for the small-scale industrial sector compared with the 1960s, when this sector was faced with raw material constraints. Also, Bhutto's nationalization was addressed towards private, large-scale manufacturing investment, which declined later for fear of further reprisals, and it is possible that some of these investment funds were diverted towards the small-scale sectors. The Asian Development Bank study argues that 'this seems particularly likely in the textile industry where many looms were uprooted from large mills and set up as small independent production units by mill owners'.[12] Another boost to the small-scale sector following nationalization was that industrial capital from the large-scale manufacturing sector was diverted to trade and exports, possibly making it easier for the products of the small-scale sector to find domestic and foreign markets.

John Adams and Sabiha Iqbal have made a number of very important observations about the growth of the small-scale sector under Bhutto. They believe that there was actually a 'considerable bias' towards the small-scale sector, government credit to which increased by 122 per cent between 1972 and 1974, and was 'sharply higher' in 1976.[13] The devaluation of the Rupee also helped, and the new import policy of Bhutto allowed industrial plants costing less than Rs. 200,000 to be freely importable against cash.[14] Since

Table 8.11
Characteristics of Formal and Informal Manufacturing Sectors in Urban Pakistan: 1983/4

	Formal	Informal	
		Small-scale	Household
No. of workers/unit	86.71	2.34	1.82
Capital stock/unit (Rs. 000)	8,261.23	24.14	7.66
Capital–labour ratio	95.28	10.30	4.20
Employment cost/ waged worker (Rs)	19.25	7.47	5.82
Proportion of workforce unwaged (family workers)	0.30	60.65	87.01

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 47.

Table 8.12
Annual Real Growth Rates in the Formal and Informal Manufacturing Sectors in Urban Pakistan: 1976/7 to 1983/4 (%)

	Formal	Informal	
		Small-scale	Household
Employment	–1.1	10.3	5.0
Capital stock	15.2	19.6	28.6
Value-added	8.7	54.6	4.2
Capital–labour ratio	16.6	8.3	22.5
Labour productivity	49.4	39.7	67.8
Capital productivity	–6.0	–2.8	2.9
Real wages for waged workers	5.7	5.0	1.0

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 48.

Table 8.13
Major Industries in Terms of Employment in the Formal and Informal Manufacturing Sectors in Urban Pakistan: 1983/4 (%)

Industry sector	Formal	Informal	
		Small-scale	Household
Food, tobacco	16.1	15.5	30.0
Textiles, leather, clothing	41.9	30.6	41.7
Wood, furniture	0.9	15.7	8.7
Paper and publishing	3.7	1.7	1.9
Chemicals	10.4	1.7	2.7
Mineral products	4.7	2.0	4.6
Basic metals	7.6	0.6	0.2
Fabricated metals, machinery, and equipment	13.7	20.0	5.9
Others	1.0	12.3	4.4
Total	100.0	100.0	100.0

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 53.

Table 8.14
Distribution of Employment within Major Industries by Formal and Informal Manufacturing Sectors: 1983/4 (%)

Industry sector	Formal	Informal	
		Small-scale	Household
Food, tobacco	45.2	36.3	15.5
Textiles, leather, clothing	54.6	33.4	12.0
Wood, furniture	5.4	82.5	12.1
Paper and publishing	66.4	25.7	7.8
Chemicals	83.5	11.7	4.8
Mineral products	63.7	22.7	13.6
Basic metals	93.3	6.3	0.4
Fabricated metals, machinery, and equipment	43.1	52.8	4.1
Others	8.3	83.9	7.8

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 53.

the small-scale sector did not fear nationalization, it attracted more private investment, and labour laws were also not strictly applied to that sector. John Adams and Sabiha Iqbal argue that the small-scale sector expanded during the Bhutto era, not because his government treated the sector in 'any exaggeratedly special fashion and it was more the absence of favouritism towards the big units that helped them'.[15]

Ali Cheema identifies yet another cause of the growth of the small-scale sector in the 1970s, which was the Cottage Industries Act of 1972.[16] The textile sector was the most affected by this, after which there was a major shift in textiles from the large-scale manufacturing sector to the small-scale and informal sector (see section 8.3).

A very pertinent point regarding the shift in the nature and composition of the small-scale sector is made by Asad Sayeed, who says that, due to the causes identified above, we see the 'emergence of the small-scale sector in the engineering and capital goods industry and textile sector also. *The important qualitative change that the above developments during the Bhutto interregnum brought about was to move small-scale manufacturing out of exclusively agrarian servicing activities to the terrain of broader manufacturing in the larger urban agglomerations.*'[17]

From the late 1970s and especially in the 1980s, Pakistan became a remittance economy, with large sums of money from the Gulf greasing the engines of industry and probably resulting in higher than average growth.[18] The large inflows of remittances and the increased purchasing power created a large demand for consumer goods, which was fulfilled by a small-scale sector eager to expand. This demand-led expansion had a multiplier effect as many of the locally produced goods had linkages with the capital goods industry, increasing demand and their production too. The construction boom of the 1980s, with increased demand for household items, was also an important catalyst, causing demand for local products to grow and having expansionary effects on the small-scale sector.

Since data regarding the actual size and trend rates related to the small-scale sector are particularly scarce, it is impossible to quantify its exact size. However, there is every indication that its growth rate is far higher than reported. It caters to a growing middle class and is being led by increased demand for goods consumed by this class. Hence, it would be interesting to know whether the sector is at all efficient compared to the formal large-scale sector, given the attitude of the government towards it in the past.

Table 8.15
Industrial Categorization: Formal, Informal, and Mixed

Purely formal	Purely informal	Mixed
Basic metals	Wood products/ furniture	Food/tobacco
Chemicals/rubber/ plastics	Others (jewellery)	Textiles/clothing/ leather
		Fabricated metals/ machinery/ equipment

Source: Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990), 54.

Table 8.16 Employment Elasticities

Sector	1961 to 1971–72	1971–72 to 1977–78	1977–78 to 1986–87	1990s to 2000s
Overall Elasticity	0.45	0.64	0.36	0.41
Agriculture	0.48	0.91	0.41	0.37
Large scale manufacturing	0.28	1.10	0.21	0.02
Small scale manufacturing				0.85
Construction	0.47	0.81	0.61	0.87
Transport & communication	1.26	0.45	0.48	0.45
Trade	0.92	0.51	0.45	0.57
Electricity & gas				0.54
Other including Services				0.68

Source: Final Report of the Panel of Economists, *Medium Term Development Imperatives and Strategy for Pakistan* (Islamabad: Planning Commission, Government of Pakistan, April 2010), 60.

8.2.3 Issues Affecting the Small-Scale Sector

Khalid Nadvi, in his comprehensive study of the small-scale/informal sector, summarizes the main features of the sector as follows:

> The informal sector consisting of small enterprises and household units appears to be expanding more rapidly than the formal sector and already provides employment to the majority of those engaged in urban manufacturing in Pakistan. Informal sector units are characterized by extremely low levels of employment and a high incidence of unwaged family workers. As to capital intensity there appears to be a distinct technology hierarchy on the basis of which household units are the most labour intensive and formal sector concerns the most capital intensive. Furthermore, capital intensity is in real terms growing more rapidly in the formal sector leading to a net displacement of labour. As a result labour productivity is substantially greater in the formal sector while capital productivity is inversely related to unit size.[19]

He also argues that 'a focus on the informal small-scale units would appear to lead to the most socially efficient allocation of capital and thereby have the greatest potential for generating productive employment'.[20]

Large productivity differences exist between the two sectors, as can be seen in Table 8.17. The labour productivity (O/L) for the large-scale sector is expected to be higher due to the higher capital–labour ratio in the sector, a trend which, not surprisingly, can be seen amongst all industries in both periods in the table. An outcome that is taken for granted in much of the literature on the small-scale sector is that the small-scale sector is more efficient than the large-scale sector in the use of capital. However, the results provided by Asad Sayeed in Table 8.17 show that the ratio K/O presents a 'mixed picture', with some industries not subscribing to the norm. Nevertheless, the increase in the ratio K/O over time shows an 'increasing relative efficiency in capital use' for the small-scale sector. Moreover, a rising O/L ratio over time for the large-scale sector indicates increasing labour productivity in that sector. Asad Sayeed concludes his analysis by saying that 'the claim that higher labour intensity in the small-scale sector leads to its higher capital efficiency is not borne out by the data'.[21]

One opinion expressed, without exception, by all scholars working on the small-scale sector is that the state or government has until very recently treated the sector usually with indifference, but often with contempt. As the previous two chapters also reveal; almost without exception—the exception possibly being the Bhutto regime—state policy has been very heavily biased in favour of the large-scale manufacturing sector.

Khalid Aftab and Eric Rahim, who have examined the phenomenal growth of the small-scale agricultural-engineering sector in the Punjab, argue that 'government policy in Pakistan during the period under consideration [the 1960s] did not assign any important developmental role to small-scale enterprises. It was never thought that small-scale producers were capable of exhibiting any dynamism. Government policies explicitly aimed at large-scale industries and large-scale enterprises received special privileges.'[22] All favourable policies were directed towards the large-scale sector and in fact, according to the Asian Development Bank study, discriminated against the small-scale sector. Asad Sayeed argues that, after the bias of the state towards the large-scale sector in the 1960s, in the 1970s and 1980s 'the only change in government attitude seems to be the acknowledgement of the existence of the small-scale sector, though with no tangible policy thrust'.[23] While it is clear that the state played no real role in explicitly promoting the small-scale sector, an interesting observation made by a scholar on the sector is worth quoting here: 'the fact that this sector is exempt from or evades any form of tax and generally free rides on utilities such as electricity, gas, water, and sewerage, means that it enjoys an implicit "hands off" policy'.[24]

Table 8.17
Labour Productivity (O/L) and Capital–Output Ratio, Small-Scale and Large-Scale: 1983/4 and 1987/8, for Selected Industries (in Thousands of Rupees)

Industry sector	1983/4				1987/8			
	Small-scale		Large-scale		Small-scale		Large-scale	
	K/O	O/L	K/O	O/L	K/O	O/L	K/O	O/L
Food	0.31	85.78	0.22	399.51	0.31	64.65	0.28	454.53
Textiles	0.23	41.11	0.40	105.98	0.44	19.86	0.45	170.49
Footwear	0.08	21.60	0.16	100.87	0.09	24.23	0.18	441.20
Wood and cork	1.04	11.35	1.24	141.21	0.88	17.34	0.94	147.41
Furniture	0.28	15.27	0.29	85.67	0.32	18.97	0.78	125.82
Non-metallic minerals	0.10	86.53	0.65	303.30	0.23	51.98	0.80	387.72
Metal and metal working	0.33	19.98	0.27	113.38	0.30	28.40	0.28	173.60
Non-electrical machinery	0.97	15.86	0.24	209.50	0.57	29.88	0.35	210.17
Others	0.23	26.62	0.36	103.16	0.39	25.45	0.26	123.58
Total	0.23	49.33	0.36	265.90	0.39	29.86	0.41	280.50

Notes: The total is weighted by the three-digit share in value-added for respective sectors for the respective periods. The above numbers for the small-scale only include 'Small Manufacturing Establishments' to the exclusion of 'Household Units' which include 10 or fewer workers. A combined estimate of the two resulted in even lower labour productivity without affecting the capital–output ratio significantly.

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 40.

There is a clear consensus on the position that the state, given the formidable contribution and growth rates of the small-scale sector, must now explicitly address the issues confronted by it and actively promote the small-scale sector. Khalid Nadvi argues that 'if manufacturing is increasingly going to be dominated by small and informal units, a larger and more comprehensive policy framework for this sector, that goes further than employment generation issues, would be required'.[25] In the late 1990s and more recently, there has been a conscious attempt by government to promote small and medium enterprises by offering them loans and providing them some support.

One of the more interesting findings of the work on the small-scale sector has been its close links with the large-scale manufacturing sector. Khalid Aftab and Eric Rahim believe that one of the reasons for the success of the Punjab firms was the overall environment of economic expansion along with the small firms' proximity to large enterprises. For the individual small producer, 'the external economies generated by the large were as important as those it obtained through the evolution of vertical specialization within the small-scale sector'.[26] Asad Sayeed, examining the experience of the successful small-scale sector in Japan and Taiwan, argues that the

> large-scale capital goods sector can create the appropriate linkages for the embodiment of technical change in equipment, which can then enhance the productivity of the small sector accordingly. Secondly, because of economies of scale, the large-scale sector can contribute towards reducing the cost of intermediate and capital goods for the small scale. Thirdly, with large firms subcontracting to the small, productivity enhancement and technical upgradation is further encouraged through user–producer interactions, quality standards, specification requirements, etc.[27]

This link with the large-scale sector can at times be critical, since the experience of countries where the small-scale sector has flourished shows that 'ultimately the fortunes of the small are intimately linked with those of the large'.[28] Hence, any strategy to improve the small-scale sector will also need to address the issue of developing an efficient large-scale intermediate and capital goods industry. Areas where linkages between the small- and large-scale manufacturing sectors already exist will need to be further strengthened so that both benefit.

The single most important constraint faced by the small-scale sector has been the availability of credit—see Boxes 8.1 and 8.2. All surveys consistently come up with this finding. Khalid Nadvi, in his survey of 328 small-scale enterprises, found that only two of them had been able to obtain credit from the formal banking sector and both the loans were of very small amounts. The constraints to borrowing from the formal sector were many:

> Formal credit from the banking sector had been obtained by only two of the sample of 328 enterprises, both cotton weaving units in Gujranwala. In both cases the volume of credit availed was low (Rs. 7,000 and Rs. 10,000) and used towards purchases of plant and equipment.

Box 8.1

Finances for the Small-Scale Sector

Abid Burki and his colleagues at LUMS, in their extensive study on industrialisation in Pakistan, examined the constraints and issues of financing the small-scale sector.

The financial market in Pakistan is shallow as firms rely on retained earnings to finance their working capital and investment needs. Trade credit and banks plays a smaller role in working capital financing; Pakistan's firms rely more on internal funds. The pattern of funding using retained earnings is robust; ranging from 88% in NWFP to 78% in Sindh.

Credit rationing in the formal credit market is a major constraint faced primarily by small- and medium-sized firms that constitute a significant portion of the industry. A study conducted by the Lahore University of Management Sciences (LUMS) in 2006 also highlighted that access to finance is the most critical impediment to the growth of the SME sector. A survey found that 57% of new investment by SMEs and 67% of their working capital comes from retained earnings, whereas according to studies conducted by international organizations, banks provide only 7–8% of the total funding requirement of SMEs. This is due to constraints on both the demand and supply side. On the supply side these are: weak and poorly enforced creditor rights, high unit costs of SME lending, and the reputation of SMEs as riskier borrowers in the financial system. On the demand side the constraints consist of loan disbursement procedures, high interest rates and collateral requirements that raise the cost of access to credi. As a result of these financial constraints it is difficult for micro enterprises and SMEs to grow in size and scale. The resultant diseconomies of scale and inaccessibility to efficient technology of production are the main factors behind their low productivity, which inhibits their growth potential.

Information asymmetries and the fear of adverse selection are factors that restrict commercial bank lending to SMEs. This is because the information that SMEs can provide to banks in the form of financial accounts, business plans, feasibility studies, etc. often lack detail and rigour. This problem is aggravated by the low level of education of small entrepreneurs. In a sample survey, 35 per cent were either illiterate or educated to below the matriculation level and unable to adequately articulate their case.

In order to mitigate the problem of asymmetric information and adverse selection, banks have adopted precautionary measures such as requiring that financing be collateralized, with collateral often exceeding 100 per cent of the loan. In the sample, the average value of the collateral was higher, the smaller the business. This, however, leads to other issues as SMEs generally do not have many assets that can be collateralized; for example, over 40 per cent of the SMEs in the sample admitted to not receiving a bank loan because they lacked the necessary collateral.

Moreover, most commercial banks regard SMEs as riskier than large firms due to many reasons. Firstly, SMEs face a more uncertain competitive environment compared to larger companies; they experience more variable rates of return and higher rates of failure. Secondly, SMEs are less equipped in terms of both human and capital resources to withstand economic adversities, particularly unanticipated economic shocks. Thirdly, their inadequate accounting systems and lack of financial controls undermine the accessibility and reliability of information on profitability and repayment capacity. Finally, SMEs in Pakistan operate in a somewhat ambiguous environment regarding governance, which reduces the security of transactions. Thus there is a greater risk that banks will not get paid, or that assets such as property will not be properly registered.

In view of all these difficulties, banks frequently refuse to lend at all or severely restrict the size of their loans to SMEs. It is, therefore, not surprising that 86 per cent of the SMEs surveyed had not acquired a bank loan. Moreover, in the total private sector credit disbursement of PKR1,669.740 billion in FY2007, the share of the SME sector was a shocking 1.7%.

Burki, Abid et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Policy Report 2010*, Lahore University of Management Sciences, Lahore, 18 October 2010, 135–7.

> All units were unregistered which technically restricted them from qualifying for credit from the formal banking sector. In addition, collateral, guarantees, lengthy procedures and detailed paperwork (usually in English) necessary to obtain formal bank loans were major barriers to those operating unregulated units. Even if collateral was available, a large number of informal enterprise owners were either illiterate or had extremely low levels of formal education and were consciously alienated from the formal procedures required by commercial banks.
>
> Alongside the daunting procedures, respondents stated that the banking bureaucracy was actively unhelpful and discouraging to small-scale informal units. Many respondents felt that the level of bribes, which they alleged had to be paid to bank officials in order to access formal bank loans, were prohibitively high for unregulated small-scale units.[29]

The small-scale and informal sectors therefore have to find credit for working and fixed capital from other sources. The sources vary according to type of industry; in some, the most important source of credit is through the linkages which exist in that sector with wholesalers, large intermediaries, or capitalists. For example, most of the loans in the carpet weaving, transport and fishing sectors are made in the form of advances with very high rates of interest, and the borrowers are almost bonded to the person making the loan. In other sectors, the nature of borrowing is less exploitative and relatives and friends, as well as family savings, provide

Box 8.2
Credit Availability to the Small-Scale Sector

Asad Sayeed discusses the problem of the availability of credit to the small-scale sector:

Proponents of the level playing field argue that once interest rates truly reflect the scarcity value of capital, it will remove the implicit bias against the small-scale producer. Given the prevalence of borrowing from the curb market in the small-scale sector, market-determined interest rates would increase the cost of capital for the large-scale sector and lower them for the latter. However, the moral hazard of lending to a large and diverse number of borrowers still remains. As Anderson argues, in a situation where interest rates are market determined and the small-scale sector is the recipient of credit, interest rates will rise to the level of the curb market, increasing the risk of default in the formal financial sector. Moreover, because the interest rate is above the actual opportunity cost of capital (because it has to cover the losses incurred by those who have defaulted), entrepreneurs in both the large- and small-scale sectors, facing interest rates above the opportunity cost of capital will be loath to borrow. Not only will there be a disequilibrium created from the demand side, but as Stiglitz and Weiss show, this will lead to adverse selection on the part of borrowers. Once the lenders decide on a more discriminatory lending policy, typically the axe will fall on the small-scale borrower. Therefore, according to Anderson:

The practical effect, therefore, of simply removing administrative controls would be for institutions not to lend rather than charge high interest rates, on the one hand, or face significant short run losses in the uncertain expectation of long-run profits on the other. The above-mentioned externality then takes the form of potentially low risk projects and efficient investments in small-scale industry being entirely excluded from access to institutional finance.

The question to ask is that given the above identified market failures in the credit market, how did the countries which have efficient and growing small-scale industrial sectors overcome the problem of moral hazard? Particularly in the case of Taiwan, real interest rates—though state controlled—were high, yet significantly lower than the curb market rates. Amsden reports that small-scale firms in Taiwan were also discriminated by the state-controlled financial sector, with the share of large firm borrowing being three times more than that of the small and even medium sized firms. The same study cites that start-up capital for small firms in Taiwan is either raised through family savings, the curb market or in many cases from windfall gains made through urban real estate. So far as working capital and at times equipment is concerned, 'big business appears to be an important source of finance for small business'. Other differences between the success stories and the failures is that small-scale is provided with adequate infrastructure, which lowers their overall cost structure, thereby increasing their profitability to the extent that they can afford to borrow from the usurious curb markets.

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995.

loans for the sector. The committee system—or *bisee*—is also an important source of funds for enterprise.

Some recommendations have been made by various scholars on how to deal with this credit constraint. There is the mainstream neoclassical argument of working through the market and providing a 'level playing field', by removing the subsidy on the interest rate on capital, and by providing a 'credit package' (see also Boxes 8.1 and 8.2). However, as the Asian Development Bank study argues, 'it must be kept in mind that SSI [small-scale industry] comprises several hundred thousand units and any attempt to provide incentives directly to individual enterprises through bureaucratic channels would be futile'.[30]

There is no denying the fact that the small-scale sector plays, and is going to play, an increasingly important role in Pakistan's economy. Rashid Amjad, for example, argued that as much as 25 per cent of Pakistan's total export earnings were generated from the small-scale industrial sector a figure, which we show, has increased.[31] Ironically, in many ways, the dynamic growth of this sector has taken place because the state has kept away from it and let it function largely on its own. Government interference or even 'help' may actually prove to cause a slowing down of this impressive growth. The recommendations from the Panel of Economists for this sector—Appendix 8.2—which focus a great deal on what the government ought to do and the bureaucratization of the small-scale sector, may actually end up with too much control of the sector undermining its dynamism.

8.3 The Textile Industry and its Crisis

When we think of the manufacturing industry in Pakistan, it is the textile industry that immediately comes to mind, and for good reason too. The textile sector holds a very important position in Pakistan's economy in terms of employment and value-added, but especially in the contribution the industry makes to exports. It has the highest manufacturing value-added for any industry in the manufacturing sector, contributing 26 per cent, with the food sector next in line, contributing 18 per cent in 2005/06. Similarly, about one-third of the entire manufactured employment was in the textile sector, with food a distant second, having only 13 per cent. In terms of exports, approximately 30 per cent of Pakistan's total exports came from cotton textiles in 1990/1, up from 20 per cent in 1982/3.[32] Cotton yarn's contribution to exports increased from 10 to 18 per cent between 1982 and 1990. These figures are only for cotton textiles, and if we

Table 8.18
Cotton Textile Statistics: 1955–2012

Years	Number of mills	Spindles (000)			Looms (000)		
		Installed	Working	% working	Installed	Working	% working
1955–1959	n.a.	1,537	1,434.2	93.3	25.1	22.2	88.4
1959–1964	74	1,674	1,629.6	97.3	28.2	26.4	93.6
1964–1969	92	2,058	1,923.4	93.5	30.4	27.6	90.8
1969–1974	131	2,877	2,711.8	94.3	29.8	26.6	89.3
1974–1979	139	3,536	2,700.8	76.4	28.0	19.2	68.6
1979–1984	156	4,077	3,008.6	73.8	24.8	13.6	54.8
1984–1989	184	4,446	3,467.0	78.0	18.4	9.2	50.0
1989–1994	271	6,356	5,150.0	81.0	14.8	7.2	48.6
1994–2000	349	8,315	6,452.0	77.6	11.1	5.0	45.0
2000–2002	353	8,707	7,284.0	83.6	10.0	4.5	45.0
1994–1999	348	8,302	6,392.4	77.0	11.4	4.8	42.8
1999–2004	356	8,932	7,298.0	81.7	10.0	4.4	44.0
2004–2009	429	11,298	9,748.2	86.3	8.4	4.2	50.0
2009–2012^P	436	11,402	10,783.3	94.6	7.0	4.7	66.7

^P = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).
All figures are 5 years average except 2009–2012^P (3 year average)

included synthetics they would be even higher. According to UNIDO, textiles constituted 56 per cent of Pakistan's exports in 1985.[33] Tables 8.18 and 8.19 give an overview of the cotton textile industry. In 2010 Abid Burki and his colleagues wrote that, 'Pakistan's economy was built around textiles and its current base is still concentrated in textiles. Cotton textile production is the most important of Pakistan's industries, accounting for about 19 per cent of large scale industrial employment and about 60 per cent of total exports',[34] but for which world demand is falling.

Table 8.19
Indices for Production of Yarn and Cloth: 1960–2012 (Provisional)

Years 2000–01 = 100	Total Yarn Produced mn Kgs	Total Cloth Produced mn Sq. mtr
1960–1965	11.0	113.7
1966–1970	13.8	118.9
1971–1975	21.1	123.3
1976–1980	19.6	81.7
1981–1985	25.6	62.7
1986–1990	41.4	54.6
1991–1995	71.4	63.8
1996–2000	90.4	74.4
2001–2005	111.1	132.3
2006–2010	161.1	202.9
2011–2012	172.2	209.5

Note: All values are 5 years average except 2011–2012 (2 years average)
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Pakistan's textile industry has lost its relatively more prominent position of the 1960s and 1970s, and today holds a little less than 2 per cent of the world market. Pakistan enjoyed a very dynamic performance in the 1960s, and was among the leading underdeveloped countries that were emerging in the world cotton textile market. In fact, Pakistan's record was quite envious, as between 1962 and 1970 it cornered over 11 per cent of the world market. By 1972 Pakistan held about 3.5 per cent of the world market in textiles, which fell to 1.5 per cent in just four years. It rose again to 2.5 per cent in 1983 and has since stabilized at somewhat less than 2 per cent.[35]

More interestingly, the share of Hong Kong and South Korea as a proportion of the world market tells a revealing story. In 1972 Hong Kong held less than Pakistan's share, with under 3.5 per cent of world output, while Korea's output constituted a mere 1.5 per cent. In 1988 Hong Kong held a little under 9 per cent, while Korea's share of the world market had risen to 6.5 per cent.[36] Some of the reasons for the relative fall in Pakistan's performance, and the rise in South Korea's and Hong Kong's contribution to world output, are discussed below.

Many fortunes were made in the 1960s by leading Pakistani industrialists, almost all of whom had significant interests in the textile sector. In 1959 the nine largest industrial houses accounted for 50 per cent of total production, with the five biggest contributing as much as 37.3 per cent. The Saigol group alone controlled 15 per cent of the total production of cotton textiles in Pakistan (West Pakistan). Of the thirteen largest industrial houses in (West) Pakistan, cotton textiles accounted for as much as 71 per cent of total production; engineering came second with only 7.9 per cent. By 1970 the top four industrial houses controlled almost 28 per cent

of cotton textiles, being produced by a mere twenty-three industrial houses.[37] What is clear from the above is that the cotton textile industry was highly concentrated amongst a few houses and that it was located almost totally in the large-scale textile manufacturing sector.

Table 8.18 presents a rather unflattering picture of Pakistan's prime industrial sector, cotton textiles. Although the number of installed spindles has been growing steadily, and shows a substantial increase, the percentage of spindles actually working has been lower than during the 1950s and 1960s.

In 2010 or so, while 95 per cent of installed spindles were working, one suspects that by 2011 and 2012 when the electricity crisis was at its peak, the actual number of working spindles would probably have fallen. For both these years, there were ample newspaper reports about the collapse of the textile industry, and industry overall, due to power shortages. In the looms sector, the position has been far worse, with only 66 per cent of installed capacity being utilized, and again here, one has seen complete or partial closure since 2010. Moreover, the number of installed looms has been cut by almost half and the number of working looms is currently less than one-fifth of that in the 1950s and 1960s. The main industry of Pakistan does not seem to be doing well at all, a fact confirmed by Table 8.19. While yarn production may have increased fifteen-fold since 1955, cloth production, having touched a peak in the early 1970s, fell to well below 1960 rates. A study on the textile sector in Pakistan gave the breakdown between small- and large-scale sectors as follows:

> The industry consists of large-scale organized sector and a highly fragmented cottage/small-scale sector. The various sectors that are a part of the textile value chain are: Spinning, most of the spinning industry operates in an organized manner with in-house weaving, dyeing, and finishing facilities. Weaving comprises of small and medium sized entities. The processing sector, comprising dyeing, printing, and finishing subsectors, only a part of this sector is operating in an organized state, able to process large quantities while the rest of the units operate as small and medium sized units. The printing segment dominates the overall processing industry followed by textile dyeing and fabric bleaching. The garments manufacturing segment generates the highest employment within the textile value chain. Over 75% of the units comprise small sized units. The knitwear industry mostly consists of factories operating as integrated units (knitting + processing + making up facilities). The clothing sectors both woven and knits are mainly clustering [sic.] in Karachi, Lahore and Faisalabad where sufficient ladies [sic.] labour is available.[38]

As Table 8.20, and sections 8.1 and 8.2 show, much of manufacturing in general, and of textile manufacturing in particular, now takes place in the small-scale manufacturing sector. The dramatic shift that took place in the nature of manufacturing industry in Pakistan, for the reasons explained in section 8.2, also affected the textile industry in a major way. For example, cotton cloth production, which was 625.3 million square metres in 1970/1, fell to 123.5 million square metres by 1988/9 largely on account of this shift from the large-scale to the small-scale sector.[39] The cottage and small-scale segment of the textile industry employs more than double the number of workers in the large-scale textile sector (see Table 8.20). According to a study by the Institute of Developing Economies, the negative productivity in the textile and garment sector is mainly the result of fragmentation of the industry, shifting from large-scale to smaller-scale units.[40]

Table 8.20
Overview of the Cotton Textile Industry: 1988

	Number of units	Equipment	Direct employment (estimates)
Large-scale mill sector			
1 Spinning	186	4.72 million spindles including rotors	150,000
2 Composite mills	44	16,000 looms	. .
3 Finishing	10	. .	1,000
4 Garments	50	3,000 sewing machines	5,000
Total			156,000
Small-scale cottage sector			
1 Power looms	15–20,000	100,000 looms	150,000
2 Finishing	150	. .	6,000
3 Towels	160	2,500 looms	4,000
4 Garments	2,500	80,000 sewing machines	150,000
5 Hosiery	550	10,000 knitting machines	20,000
Total			330,000

Source: UNIDO, *Pakistan: Towards Industrialization and Revitalization* (Oxford: Blackwell, 1990), 54.

Ali Cheema states that

> under the Bhutto government the textile sector lost the importance it held in the state policy regime in the '60s. This is because the emphasis of the state shifted towards the creation of public sector intermediate and capital goods industry and was no longer on the promotion of growth through manufacturing exports.[41]

Moreover, the Cottage Industries Act created a bias against large-scale production and according to Cheema, 'this act changed the structure of the industry in the textile sector', resulting in the fragmentation of firm size. Both output and employment in the small-scale sector grew significantly after the Act, with the number of power looms increasing from 20,000 in 1968 to 32,000 in 1972 and to 53,000 in 1978.[42] Moreover, the nationalization programme of the Bhutto government broke the hold of the large-scale manufacturing sector generally, but most importantly, the power of this group was significantly depleted as the critical link between the financial and industrial sectors was ruptured. John Adams and Sabiha Iqbal concur with this view, arguing that the policies that Bhutto's Finance Minister 'put into place were the single most important cause of the poor performance of the textile industry,'[43] since the nationalization of major industries, banks, and insurance companies, and the new labour laws enacted, were all against the interest of large industry, where the textile sector was located.

Table 8.21 shows how Pakistan's textile industry performed compared to Hong Kong's and South Korea's between 1973 and 1987, and explains the reasons why Pakistan's share of the world market in textiles fell during this period and why those of Hong Kong and Korea increased. Asad Sayeed argues that

> both Hong Kong and Korea captured greater market shares as a result of a much larger component of their growth in exports coming from the competitive effect. This means that these countries were able to break into world markets on the basis of more dynamic production and marketing performance rather than merely relying on growth in the world market or product specialization at a given time.[44]

Table 8.21
Constant Market Share Analysis: Pakistan, South Korea, and Hong Kong: 1973–87

Country	World trade effect	Commodity composition effect	Competitiveness residual
Pakistan	82.1	41.9	–24.1
Hong Kong	41.1	9.5	49.4
South Korea	24.6	5.9	69.5

Sources: Compiled from: Cheema, Ali, 'Pakistan's Textile Policy and Trade Performance, 1972–90,' mimeo (Cambridge: Sussex College, 1995), and Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 115.

Further reasons given by Ali Cheema for this fall in world output share relate to the fact that both Hong Kong and Korea shifted into higher value-added subsectors like man-made cloth and bleached cotton cloth. He writes that 'Pakistani entrepreneurs on the other hand ignored upgradation into either downstream higher value-added processes and/or into higher value-added products within each subsector.'[45] Essentially *Pakistan failed to diversify* into other products and lines at a critical juncture when the world textile industry was undergoing change. This conclusion is reinforced by the fact that despite the imposition of import quotas by the advanced capitalist countries, Pakistan was even unable to meet the quotas. Moreover, both Hong Kong and Korea faced a stricter quota regime than that applicable to Pakistan. While both these East Asian countries were able to beat the quota constraint by diversifying and upgrading into higher value-added and quality products, Pakistan was not able to meet this challenge, and hence suffered.

Asad Sayeed argues that the 'loss in world market shares points to underlying inefficiencies in the textile sector, in spite of relatively high productivity growth in the sector',[46] and this is despite the fact, as pointed out by the World Bank, that 'the textile industry in Pakistan is the *most efficient industry within the manufacturing sector*'[47] (see Box 8.3). For UNIDO, the factors that will have to be addressed in order to increase the textile performance include problems presently related to 'a narrow production base, outdated technology, limited product range, [and] increase in quality consciousness in importing countries'.[48] (Appendix 8.2 in the first edition of *Issues*, tries to identify some political and institutional factors that have resulted in the deterioration of the textile industry in recent years).

Zubair Bandukda highlights many of the pressing issues which affect Pakistan's most important industry, that of textiles. He argues, that while Pakistan is the world's fourth largest cotton producer with an annual production of now around 12–14 million bales and its cotton fibre is considered one of the best in the world, due to poor picking, ginning, and elimination of contamination, it loses this advantage. Pakistan is also ranked fourth in terms of spindles and twelfth in terms of rotors installed, and is the world's fourth largest cotton yarn producer as well, after China, India, and the USA.[49]

About 70 per cent of Pakistan's yarn production is coarse cotton yarn and only 3 per cent accounts for fine and super fine counts. Pakistan is one of the largest exporters of cotton yarn in the world, in terms of quantity, but in terms of value it captures only 5 per cent of the export market. This shows the low value-added nature of Pakistan's exports of yarn.

In terms of weaving as well, Pakistan is the world's fourth largest exporter of woven cloth, although much of the woven fabric is of low value, which is attributed to the low level of technology both in the weaving and processing sector, with processing the weakest link in the entire textile value chain. In the world's largest market of cotton fabrics,

Box 8.3

Efficiency in the Textile Sector

The World Bank in its evaluation of the textile sector has argued somewhat surprisingly as follows:

The textile industry in Pakistan is the most efficient industry (DRC = 0.92) [DRC: domestic resource cost] within the manufacturing sector. Efficiency is, however, far from uniform, with DRC estimates at the product group level varying from 0.72 for cotton spinners to 2.20 for woollen products. In general, the industry is more efficient in the spinning of locally sourced fibre (cotton) and the use of the same in made-up items (towels, canvas, knitwear, and garments). It is relatively less efficient in the conversion of spun short staple and filament yarn into cloth (both finished and grey) and is least efficient in the conversion of imported fibre (wool) into both yarn and cloth. Internationally, the textile industry is characterized by large-scale integrated operations employing very sophisticated technology to produce an increasingly more demanding product. Both the weaving and finishing industry and the woollen industry in Pakistan are characterized by small-scale, non-integrated units employing very simple, relatively labour intensive technology to produce a product of questionable quality.

The industry as a whole operates within a largely neutral assistance regime (EPR=13%) [EPR: effective protection rate], earning average private financial returns of 17 per cent which are approximately equal to the estimated public economic return of 18 per cent. This picture is, however, highly misleading. Some 25 per cent of domestic resources are employed in industries which are very efficient and are negatively protected. These industries are all characterized by the use of man-made fibre (MMF) and are unable to pass-on an average 24 per cent distortion in input prices to their consumers because of competition from a close substitute—pure cotton textiles—which is generally priced domestically at or near the world price. Such a situation is hardly conducive to the growth of the MMF section of the industry which is necessary if Pakistan is to develop a more balanced profile relative to international demand trends.

The increased availability of imported fabric and garments after implementing the trade reform would induce a restructuring of parts of the textile industry. Such a restructuring will help Pakistan's textile sector to make better use of its competitive advantage in world markets. The trade reform would eliminate the bias against the use of man-made fibre. Cotton spinning (including mixed-fibre) would become more profitable despite the elimination of the export tax on raw cotton. In all other areas of the industry profits will suffer, unless the efficiency of production is increased, in particular the weaving and finishing and woollen yarn industries which are currently operating under high protection with low levels of efficiency.

Source: World Bank, *Pakistan: Country Economic Memorandum FY93: Progress Under the Adjustment Programme*, Report No.11590-Pak (Washington DC: World Bank, 1993), 48–9.

Pakistan's finished cloth share is extremely small, only 3 per cent of global trade. It is important to emphasize that while Pakistan's main exports are textiles and garments, they occupy a dominant position in the low cost and low quality cotton fabrics market.

The reason for this is that apart from a small number, the majority of processing units in Pakistan are not integrated but independent commercial dyeing, printing, and finishing units. Most of these units have low dyeing technology catering to the processing requirements of the low-end knitting and woven fabric manufacturers. Textile made-ups (towels and bed-sheets) as well as the garment industry's demand are also met by such units.

Textile processing is a technology-oriented business which requires capital-intensive technology, but most of Pakistan's machinery in this sector is more than fifteen years old and requires a major overhaul to upgrade it to quality and modern standards. The tendency is to invest in the printing side of the industry even though the dyed fabric is a higher value product compared to printed fabric and fetches a higher price. This trend is driven by the dominance of the power loom sector for the supply of woven fabrics. There is a need to invest in the dyeing side of the industry rather than printing which will result in the unit price of the fabric being exported.

In the textile sector, the biggest growth is taking place in the share of clothing and apparel. Clothing trade since the 1990s has grown at a rate of 82 per cent compared to textiles, 4 per cent, with both accounting for around $160 billion worldwide. Pakistan has at best 1 per cent of the global apparel market, primarily because Pakistan exports have a low share of value-added goods, which continues to increase. This means that while Pakistan has a higher share in the low value-added segment of the market, its export earnings will remain low unless the textile industry diversifies and moves into the high value-added, quality garments and made-ups sector.

In light of globalization and WTO agreements, Pakistan's textile sector has entered a completely different realm of competition and issues—see Chapter 9 Section 9.5. Musleh-ud-Din and Kalbe Abbas[50] have examined the impact of these changes and in light of these new conditions have made some recommendations which are worth considering. They argue that in the past although the textile and clothing industry has been protected under high tariffs, with subsidies, concessionary finances, subsidized cotton prices, and numerous other incentives and breaks, it has not been able to achieve high efficiency, and as we show above, has not made an entry into the high end of the quality market.

In order to take advantages of these changes, Pakistan will have to improve its quality standards across the board, from raw cotton to finished products. More research and development is required in types of cotton especially the superior long staple varieties of cotton. Musleh-ud-Din and Kalbe Abbas also recommend that Pakistan move into

synthetic fibres as this sector has been growing in recent years. Most importantly, Pakistan will have to move into higher value-addition products rather than depending on low-end or intermediate products. This would require a strong and modern weaving and processing base. Moreover, the problems which have affected Pakistan's overall industry since 2010, such as electricity and gas shortages, will also have an impact on Pakistan's textile sector. In addition, a global recession also bodes ill for Pakistan's main exports. While the value of textile exports from Pakistan may have grown in 2011, this was largely a price effect, due to the international rise in cotton prices, not so much a quantity effect. Hence, when cotton prices fell, as they did in 2012, both the volume and value of Pakistan's main exports also fell, and will continue to do so, unless some of the structural (internal to the textile sector) changes as discussed are implemented. See Appendix 9.3, in Chapter 9, on the repercussions of the post-quota regime and Pakistan's textiles sector.

8.4 Has Public Sector Industry Been a Failure?

The public sector and the role of the government in general have been much maligned and discredited in recent years. There has been a wave of denationalization and privatization of state-owned enterprises not only in underdeveloped countries, but in advanced capitalist states such as the UK as well. Not only have publicly owned and managed industrial and non-industrial units been handed over to the private sector, but with the process of liberalization, deregulation, and so called market-friendly policies adopted by underdeveloped countries, usually in the guise of a Structural Adjustment Programme, the role of the state in the provision of basic social and infrastructural facilities has also diminished markedly. Today, the conventional wisdom is that, as far as intervention by the government is concerned, 'less is better'. So, in many ways, the existence of public sector industries is itself in question, and with the increased pace of privatization taking place in most countries, including Pakistan, one wonders if in a few years any state-owned enterprises will exist at all. One of the reasons why the privatization process is proceeding at such a pace is that there is a strong belief that public sector enterprises are inefficient, costly to run, poor performers and a major drain on the exchequer. The argument goes that the state should no longer subsidize loss-making enterprises and they should be either sold to the private sector to run and manage, or closed down altogether. This section will evaluate the role, conditions and performance of public sector enterprises in Pakistan.

Figure 8.1 gives a chronology of the main developments with respect to public sector enterprises in Pakistan. The main expansion of public enterprises took place under the government of Zulfikar Ali Butto following his nationalization programme of 1972. The role of public sector industry in the 1950s and 1960s was mainly to supplement and assist the private sector, which was considered to be the leading vehicle of industrial development. The 1972 nationalization process reversed that trend, with the public sector taking the lead.

Prior to 1972 the main public sector industries were managed by the Pakistan Industrial Development Corporation (PIDC), which was created in 1952 with the aim of accelerating the rate of industrial development in the country. PIDC was 'to invest in fields in which private investment would be weak due either to technological complexity or the lack of immediate profit potential. It was also to transfer its projects to private entrepreneurs once they became profitable in order to promote and strengthen the private sector.'[51] It was also expected to promote some sense of regional balance between East and West Pakistan, developing industries in backward areas.

PIDC played a very important and effective role in fulfilling its mandate and initiated numerous projects in the jute, fertilizer, heavy engineering, and cement industries, some of which were later sold to the private sector. More importantly, however, it acted as an important 'catalyst in the subsequent development of these industries'[52] by training labour and creating important linkages with other sectors. In many ways, the role of PIDC was one of a pioneer, leading the way for the private sector in later years.

In the period 1972–7 the role of the public sector was considerably expanded, and by 1977 the government was 'heavily involved in finance and insurance, manufacture, transportation and communication, and energy. It had also entered the construction, trade and commerce, mining, and agricultural sectors.'[53] The Zia ul-Haq regime did not increase the role of the government by establishing new public enterprises, and much of the public sector investment during the early years of the Zia period went into ongoing projects. Although very little was privatized under the Zia government, the role of the public sector began to diminish as the private sector was unabashedly chosen as the leading vehicle to bring about economic and industrial development. After 1991 the contribution of public sector enterprises was further minimized with the launch of the privatization programme (see Table 8.22 for the share of the public sector in various activities).

Given the abhorrence of the regimes after Zulfikar Ali Bhutto towards the public sector enterprises and the desire to get rid of these units by the different governments since 1991, one might have the impression that the state was burdened by these loss-making, inefficient units and wanted to rid itself of them as soon as possible and at any price. Interestingly, however, the evaluations undertaken of the public sector at different times since 1977 paint a very different picture.

It must be remembered that public sector enterprises have, not merely to respond to pure market criteria, but also have social and political responsibilities and motives. Hence the 'inclusion of socio-political goals in the objective function of the existence and operations of public industrial enterprises can pull down productivity and profitability of these units'.[54] This means that the overall evaluation in financial or economic terms, as reported, will be less than the actual contribution and outcome of the public sector enterprises. Nevertheless, despite this proviso, their contribution has been very impressive.

Table 8.23 shows the important indices of the public sector industries compared to the overall manufacturing

Figure 8.1 A Chronology of Key Developments in the Public Enterprise Sector

Event	Date
Establishment of the Karachi Port Trust as the first public enterprise in what is now Pakistan	1886
Establishment of the Karachi Electric Supply Corporation (it became a public enterprise in 1952)	1913
Establishment of the Pakistan Refugees Rehabilitation Finance Corporation as one of the first public enterprises in independent Pakistan	1948
Establishment of the National Bank of Pakistan as the first public enterprise in the finance sector	1949
Establishment of Pakistan International Airline Corporation as a public enterprise and government monopoly in the air transport sector	1955
Establishment of the Pakistan Industrial Credit and Investment Corporation as the first development finance institution	1957
Establishment of the Water and Power Development Authority as a public enterprise and the major electrical power producer, transmitter, and distributor	1958
Establishment of four development finance institutions to assist in the economic development of the country:	
Industrial Development Bank of Pakistan	1961
Agricultural Development Bank of Pakistan	1961
National Investment (Unit) Trust	1962
Investment Corporation of Pakistan	1966
Establishment of the Oil and Gas Development Corporation as a public enterprise in the fossil fuels energy sector	1961
Establishment of the National Shipping Corporation as a public enterprise in the sea transport sector	1963
Establishment of the Pakistan Steel Mills Corporation as a public enterprise in the heavy industries sector	1968
Nationalization of 31 large firms in 10 'basic' industries. The private firms became public enterprises.	1972
Nationalization of the vegetable oil industry. The private firms became public enterprises.	1973
Nationalization of private, domestically-owned banks and insurance companies. The private firms became public enterprises.	1974
Nationalization of 2,000 rice, flour, and cotton ginning mills. The private firms became public enterprises.	1974
Denationalization of 2,000 rice, flour, and cotton ginning mills	1977
Efforts initiated in the Ministry of Production through its Experts Advisory Cell to improve the performance of 56 of its public enterprises	1981
Establishment of the National Disinvestment Authority	1985
Junejo government agrees to permit the private sector to establish banks.	1986
Junejo government permits private sector firms to bid on construction contract for electrical power station.	1986
Benazir Bhutto pledges no more nationalization of industry in the election campaign of 1988.	1988

Source: Ahmad, M. B. and R. Laporte, *Public Enterprise in Pakistan: The Hidden Crisis in Economic Development* (Boulder, Colorado: Westview Press, 1989), 173–5.

sector in the period 1972–82. There is little doubt that the public sector industries performed far better than the overall manufacturing sector, *even under the Bhutto government* (1972–7) when the nationalization and pro-public sector policies were severely criticized and considered to be a failure. By no stretch of the imagination, based on Table 8.21, can one reach that conclusion. While public sector industries did fairly well under the Bhutto government, they performed *even better* under the more open and liberal economic regime of Zia. There was a significant increase in profits and productivity by the state-owned enterprises in the early Zia period, possibly due to a pro-investment and growth-friendly, overall economic and political environment, encouraging economic growth. Moreover, under the Zia regime a number of new units, initiated earlier, came into production. Asad Sayeed shows that the *weighted average of productivity growth in the public sector was higher than that of the private sector* once the numbers for the Steel Mill are removed from the sample. This, he argues is a 'surprising result', where apart from Pakistan Steel, 'the two sectors were equally (in)efficient'.[55] Sayeed's analysis clearly questions the biases perpetrated by the World Bank, which has played a central role in discrediting the contribution by the public sector. With reference to the late 1980s, a World Bank study argues that 'the private sector was confronted with pervasive regulatory controls in manufacturing and *burdened by large public enterprises suffering from poor performance and inefficiency*',[56] which clearly seems to be untrue.

A more detailed analysis has been conducted by Nawab Haider Naqvi and A. R. Kemal, who have extensively analysed the performance of public sector enterprises. The salient conclusions from this analysis are as follows:

1. Of the eight corporations which run the public enterprises, five of them, accounting for 71 per cent of output originating in public enterprises, have been *'reasonably profitable* even from a strictly commercial view'.[57]

Table 8.22
Share of the Public Sector in Various Activities: 1960–88 (%)

	1960/1	1965/6	1970/1	1974/5	1984/5	1987/8
Agriculture	–	–	–	–	–	–
Forestry	–	–	–	–	–	–
Fishing	0.0	0.0	0.0	0.2	–	–
Mining	3.7	19.1	24.9	10.1	93.0	93.0
Manufacturing	2.1	2.4	2.4	8.1	11.1	10.1
Electricity and power	85.0	98.2	65.0	77.5	100.0	100.0
Construction	0.0	0.0	0.0	0.0	0.5	0.4
Trade	0.0	0.1	0.4	7.9	1.3	30.2
Transport and communication	62.3	44.1	34.2	33.9	30.1	30.3
Finance	n.a.	n.a.	14.6	67.5	95.2	95.2
Others	0.0	0.0	0.0	0.0	0.1	1.6
Share in GDP	4.9	4.8	4.2	7.7	10.6	11.6
Share in non-agricultural GDP	9.3	7.9	6.6	11.5	14.3	13.7

Source: Kemal, S. N. H. and A. R. Kemal, 'The Privatization of the Public Industrial Enterprise in Pakistan', *Pakistan Development Review*, vol. 31, no. 2, 1991, 111.

Table 8.23
Output, Employment, and Productivity Indices of Public Sector Industries and the Manufacturing Sector: 1972–82

	1972/3	1973/4	1974/5	1975/6	1976/7	1977/8	1978/9	1979/80	1980/1	1981/2
Public sector industries										
Production value (constant 1972/3 prices)	100	131	160	167	162	117	126	166	169	192
Employment	100	119	136	14	158	100	102	109	121	126
Labour productivity	100	111	118	116	102	117	124	152	140	152
Productivity index[a]	100	120	123	120	n.a.					
Manufacturing sector in Pakistan										
Production index (includes SSI)	100	107	108	100	110	109	114	126	139	155
Employment index	100	103	115	120	128	105	115	114	119	122
Productivity index	100	104	94	92	86	104	103	111	117	127

Source: Federal Bureau of Statistics, *Annual Report on Public Sector Industries, 1981–82*, 1981–2, except[a] productivity index, which is from Ahmed, Viqar, and Rashid, Amjad, *Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984).

2. It is presumed that the effective rates of protection are usually higher for the public sector than for private enterprises, but their results show that these rates are relatively *lower* in industries where public enterprises dominate.
3. The industries dominated by the public sector do not suffer from a higher level of inefficiency than that observed in the private sector, hence *'efficiency levels across industries are independent of the locus of ownership'*.[58]
4. *'The incidence of the worst kinds of allocative inefficiency is in the private sector rather than in the public sector.'*[59]
5. Of the sixty inefficient industries identified, only 9 were in the public sector.
6. Capacity utilization is high in public enterprises, where thirty-nine of the sixty enterprises had capacity utilization rates exceeding 75 per cent.

The overall conclusions of Nawab Haider Naqvi and A. R. Kemal regarding the public sector are forcefully articulated as follows:

> The public sector's profitability is due not to the higher level of protection that it enjoys (indeed, the effective protection rates are lower for them) nor due to any restrictions placed on the entry of new firms, but to its better performance and superior productive efficiency; and the charge of the *inherent* inefficiency of the public industrial enterprises is based neither on good theory nor solid empirical evidence.
>
> The basic message that comes out clearly . . . *is that changing the locus of ownership of industries is by itself neither a necessary nor a sufficient condition for an efficient operation of specific industrial enterprises.* Indeed, . . . both the private and public

> sector firms have operated efficiently as well as inefficiently, depending on the type of industry to which they belong. These results suggest very strongly that, in Pakistan, *there is nothing inherently good or bad about the public sector; or even about the private sector for that matter*.[60]

Finally, for them, 'where industrial inefficiency is the problem, steps should be taken to improve the situation regardless of the locus of ownership. The divestiture of public enterprises, mainly on ideological grounds or to secure dubious gains, or to satisfy the sensibilities of donors and creditors, is certainly not an optimal policy.'[61] These arguments, based on an extensive evaluation of public sector enterprises, were made in the 1990s, and following a thorough analytical account, make very strong arguments which went against the then emerging conventional wisdom. In the early 1990s when the IMF and World Bank sponsored Structural Adjustment Programmes were underway, there were groups and interests who were actively trying to malign the public sector. Since the 1990s, much has changed in the world, in Pakistan and in public policy as well. The movement to undermine the state and government intervention, has won many victories against those who would argue in defence of state-owned enterprises. The ideological map of the world has shifted, to one of free enterprise and free markets, where the private sector is said to be the main instrument of economic growth and development. This is the new conventional wisdom, and in Pakistan too, the dominant view in public policy circles, both independent and government, is that the public sector is a major burden on the exchequer, that state-owned enterprises are always mismanaged, cesspools of corruption, inefficient and loss-making—see Box 8.4. And hence, they should be privatized.

Given the actual performance of such enterprises, especially in Pakistan, it does become difficult to make a case for the defence of such institutions and organizations, especially when public perception also supports such claims. However, it would be unfair to dismiss the public sector in one sweep and make arguments for the privatization of all state activity. A more careful analysis of the public sector is required to provide a more balanced view and not to be caught up in the fashion of the times, such as privatization.

8.5 The Privatization Process

One of the most controversial and interesting aspects of the Structural Adjustment Programme since 1988 has been the privatization programme begun in 1990. Six years later, in 1996, it was still provoking strong reactions by observers (see Box 8.5). While governments may be pleased at privatizing a reported 65 per cent of the targeted industries, the way the process had been managed and the consequences of this programme have been subject to debate, controversy and mainly criticism (see Appendix 8.3 in the first edition of this book).

A large-scale privatization effort was launched in November 1990 by the Nawaz Sharif government when the Disinvestment and Deregulation Committee was established to identify the enterprises to be privatized and to make recommendations on how this process should take place. Earlier, the first Benazir Bhutto government also paid lip-service to the concept, and said that it would privatize the state-owned sector, but no manufacturing industry was targeted for disinvestment and not much in the form of privatization actually took place. The reason that the government gave for the slow pace of privatization was 'that it wanted to conduct an exercise that was transparent, well-conceived, and broad-based'.[62] Most critics felt that the government was dragging its feet and lacked the commitment and political will to carry the policy through.

The Disinvestment and Deregulation Committee established the principle that the government should completely retire from the production of industrial goods, and identified 109 industrial units that should be privatized at the earliest opportunity, and four of the five nationalized commercial banks, which had 88 per cent of total deposits with them (see Table 8.24). The Committee was dissolved and replaced by a Privatization Commission in January 1991, which was to supervise the privatization process. The mandate of the Commission included the valuation of public enterprises that were to be privatized, based on the assessments made by independent consultants, the implementation of the bidding process and the supervision of the transfer of the units to the private sector.[63]

In the early phase of privatization, the programme was unsuccessful with few bidders for the targeted firms. Since privatization was a cornerstone of the government's economic policy, the government revised its strategy and accelerated the process. It improved the legal and administrative procedures, and while it had decided initially to adopt the policy of offering only a few units for sale at a time, it reversed this policy in October 1991, and advertised all the 105 industrial units for immediate sale. Attempts were also made to make the entire privatization procedure more 'transparent' and effective.

One of the reasons for privatization has been the need to raise revenue. However, this measure is fraught with problems, as an important report on Pakistan's industrial sector identifies:

> Privatization is being undertaken partly to offset declining budgetary revenue and partly to compensate for government investment shortfalls. It is hoped that liberalizing the economy and opening it up to competitive pressures will encourage private investment. An option open to the government is to commercialize public enterprises. The commercialization of some of the public enterprises has enhanced their financial performance since 1983. While an improvement in the performance of public enterprises may be a catalyst for further industrial progress, progressive expansion of the private sector will depend on a number of far-reaching changes in the industrial investment environment, including an improvement in the law and order situation which has adversely affected industrial development in recent years.[64]

Box 8.4

Why State-Owned Enterprises Fail

Ihtasham ul Haque examines the role and working of state owned enterprises in Pakistan and argues how these enterprises malfunction, having a major cost on the budget. He finds that poor governance and management are the main reasons for their failure.

In any country's economic mosaic, State Owned Enterprises (SOEs) are the mainstay of self reliant growth. They help create infrastructure, absorb technology, encourage innovation, and generate employment while serving many social objectives. Sadly, this has not been the case in Pakistan. The country's 200-plus SOEs continue to haemorrhage, incurring over Rs. 400 billion in annual losses (an amount greater than what the government spends on the development budget in the whole year). And recurrent political interventions in almost every conceivable area of decision-making concerned with the working of these SOEs are only exacerbating matters.

The losses of the SOEs have increased in recent years and are now estimated to be worth 1.5 per cent to 2 per cent of GDP. This is mainly due to poor governance, mismanagement, mounting corruption, and inappropriate policies coupled with flawed internal structures. The government has expressed its concern over the alarming health of SOEs on more than one occasion yet has failed to undertake any meaningful reform with a view to restructuring and revamping them along modern lines.

The challenge of improving efficiency and putting these SOEs on a viable commercial footing is a formidable task. "Reforms are needed, including a separation of these enterprises from operational interference by government ministries,' states the Asian Development Bank (ADB) annual report for 2012. According to the bank, the economy continues to be affected by structural problems, including a domestic energy crisis, a precipitous decline in investment, persistently high inflation, and security issues. Meanwhile, budget deficits remain high, driven by substantial subsidies and losses at state-owned enterprises, aggravated by minuscule tax revenues.

Concerned government officials largely agreed with the ADB and admit that financial guarantees outstanding against the loss-making enterprises have crossed Rs. 600 billion. 'The main hurdle in the restructuring process is the stiff opposition by concerned ministries, including the bureaucrats, and the restructuring and revamping plans are heading for a flop,' says a senior official at the Planning Commission.

Finance minister Hafeez Shaikh is blamed for not taking an interest in introducing effective reforms for these enterprises, unlike his predecessor Shaukat Tarin. The finance minister has vowed to introduce such changes but so far, no breakthrough has been achieved.

In one of her presentations, former State Bank of Pakistan governor Dr Shamshad Akhtar said that SOEs contributed almost 10 per cent of GDP. She maintains that progress on reforms within SOEs stalled because of the political and economic uncertainty and concerns regarding the valuation of companies in their current state. Based on international best practices, she had proposed the setting up of an International Finance Commission-sponsored public-private partnership, which would apply corporate strategies and benchmarks to the operational, financial and service standard performances of the SOEs, with a view to making them economically viable.

Meanwhile, the call of experts to get rid of loss-making public sector units by privatizing them has faded over time. In its initial years—particularly in the early and mid-nineties—the privatization process remained relatively successful. But eventually, the allegations of selling SOEs at throw-away prices started reverberating. Meanwhile, global economic conditions also deteriorated at a fast pace, forcing potential buyers to desist from taking part in the disinvestment process. And the recession currently gripping Europe and the Americas mean that there are hardly any funds, which can be mobilised.

The ADB's flagship annual economic publication, the Asian Development Outlook 2012, highlights public sector losses as one of the major factors impeding growth in the Pakistan. The annual losses at the SOEs are attributed to a mix of inappropriate governance, corruption, inefficiency, and flawed policy. For example, power sector losses amounting to Rs. 250 billion have resulted in the creation of the gigantic Rs. 400 billion circular debt. Other major loss-making SOEs include PEPCO, PIAC, Pakistan Steel Mills, and Pakistan Railways.

The biggest drain on the exchequer is that of the Pakistan Electric Power Company (PEPCO), which is incurring a loss of over Rs. 1 billion per day. This is despite the fact that the government has continuously increased electricity tariffs at the rate of two per cent per month since 2011. While the government claims to have added 3,500 MW of electricity to the national grid over the last four years, global power statistics issued by British Petroleum reveal that power production in Pakistan has actually decreased by 10 per cent since 2008. The losses of PEPCO power distribution companies are on the rise while revenue collection of even the billed amounts is declining. The power losses of the Sukkur Electric Supply Company, for example, exceed 40 per cent while collection of the billed amount is only 59 per cent. Similar issues mar the productivity of other supply companies, which continue to incur losses and fail to collect much-needed revenues.

The losses of SOEs peaked in 2011 when their performance reached the lowest ebb in Pakistan's history, threatening the economic viability of the state. Pakistan Railways, PIA, Pakistan Steel Mills, Pakistan Agricultural Storage and Services Corporation (PASSCO), and Utility Stores Corporation continue gobbling up additional funds, making no money of their own.

PIA has become a textbook case of poor governance and political intervention and suffers losses of Rs. 70 million daily. (Its cumulative losses are estimated to be substantially more.) The last three years have witnessed the recruitment of over 2,300 people in PIA, who translate into a Rs. 100 billion loss. Promises to rightsize PIA remain unfulfilled while the number of operable aircrafts has dwindled to half. Instead of focusing on the cause of this efficiency, the government has offered PIA long-term financing for working capital, guaranteed its borrowing, and continues to pay financial charges on selected debt securities.

Meanwhile, Pakistan Railways burns Rs. 50 million every day of the year, after having incurred a loss of Rs. 35 billion in 2011–12. Since the current government took power in 2008,

PR has retired 104 of its 204 trains. Even though PR has almost come to a halt, the government has not laid off a single employee. This is despite the fact that the PR management admits that of its 110,000-strong staff, only 40,000 are required. In the meantime, PR gets Rs. 2.5 billion a month from the government for payment of salaries and pensions alone.

Pakistan Steel, on the other hand, has been out of production for several months due to want of raw material. Even so, a total of Rs. 30 billion has been doled to PSM to help cover the financial losses caused primarily by overstaffing on political grounds and rampant corruption and nepotism.

While some SOEs such as the two ports, OGDCL, PSO, SSGC, SNGPL, and the insurance sector are still showing some profits, the point to remember is that they still lose a significant amount which remains hidden due to the inherent profitability of such entities.

In a 1954 speech, former Indian premier Jawaharlal Nehru referred to SOEs as the 'temples of India' in view of their importance to the economy. But in Pakistan, the biggest impediments to the revival of SOEs are the shoddy quality of their boards, the lack of ownership and accountability, as well as a flagrant disregard of merit in appointments. The government must learn to look beyond the tip of its decidedly political nose and implement strict reforms. It must decide whether it is the business of the government to run business and, if so, what are its security-related or economic reasons for doing so. And finally, it needs to manage these investments on a sound commercial basis, separated from the government's function of policy making, market regulation or social obligations.

Source: Haque, Ihtasham ul, Bleeding to Death, *Money Matters*, *The News*, Karachi, 2 July 2012

Box 8.5

Privatization Controversy Reveals Some Unsavoury Aspects

A number of articles in the press criticized the government of Benazir Bhutto for its policy and manner of privatizing state-owned enterprises. Sultan Ahmed writes:

The controversy in respect of privatization of large public sector units is getting heated again, and is acquiring an increasing number of disturbing facets.

The disputes are over the timing of privatization of large public sector units, such as UBL, Bankers Equity, and the selling of 26 per cent of the shares of the Pakistan Telecommunications Corporation (PTC) to a strategic buyer, over the specific use the large sale proceeds of what is often described as the family silver should be put, and about the methodology or transparency of the transactions which have not been found to be satisfactory.

The question of timing of the sale is very important. To begin with, share prices in Pakistan are low, and the Karachi Stock Exchange price index at 1,488 is about 44 per cent below the peak of 2,661 achieved twenty months ago, and has been in the doldrums for too long a time without a significant and sustained break. Worse still, the PTC shares sold abroad at Rs. 55 per share have swung between Rs. 28 and Rs. 30 making many foreign investors disinvest and move to greener pastures.

Foreign investors are usually ready to buy shares of bigger enterprises when the economy is booming, and not when it is stagnating and when they see that an economic breakthrough is imminent. That is not the case in Pakistan as the economic growth has been too low during the last three years—2.3 per cent, 3.8 per cent and 4.7 per cent despite the high growth targets set for each year. The growth target set for the current year [1995/6] is 6.9 per cent, and expectations suggest that the performance this year will be better than earlier years, particularly as the cotton crop may be as much as 10 million bales or more.

For a number of reasons, not only former Prime Minister Nawaz Sharif and former Finance Minister Sartaj Aziz have cautioned against hasty privatization of large public sector units but President Farooq Leghari has also joined the chorus. Addressing the two-day Asia-Pacific Privatization Conference in Islamabad he said: 'We cannot allow distress sale of our national assets', and wanted the privatization to take place in the best possible financial and legal environment.

When it comes to the using of the sales proceeds of privatization there is a large national consensus that they should be used for reduction of the overwhelming national debt, domestic as well as foreign. During the days of Moeen Qureshi as caretaker Prime Minister, he set up the Debt Reduction Fund to which the sale proceeds of privatization were to be credited. Dr Mahbub ul Haq is emphatic that the funds should be used for reducing the costly debt.

The government, however, has other ideas and it has talked of setting up a 'Future Generations Fund' and utilizing that for promoting education, employment, etc. And it has already used Rs. 11 billion for its Social Action Programme [SAP] and has budgeted for an outlay of Rs. 12 billion this year on the SAP.

How much is the money received so far from privatization? Various figures have been given, but not a clear well audited picture. We need a clear and complete picture now. Makhdoom Shahabuddin, Minister of State for Finance, said recently that until June 1993 Rs. 5.467 billion was received from privatization and since then Rs. 30 billion, making a total of Rs. 35.47 billion. But then, through the sale of 6 million vouchers of PTC alone Rs. 30 billion was received. He also said the Privatization Commission had so far used Rs. 13.98 billion for reducing domestic debt to the extent of Rs. 6.13 billion and the balance for the SAP.

Commenting on the issue, President Leghari has said the cynicism about privatization must go, and it is for the Prime Minister, the cabinet, and the Privatization Commission to ensure that the cynicism is replaced by enthusiasm at the national level. 'It is time the government came up with a categorical well-audited statement on the use of the privatization fund for debt reduction and gives complete details of the funds received, spent, and the balance.'

The third controversy is over the methodology of the privatization and the extent of transparency. The latest controversy in this regard is around the sale of 266 kanals of land belonging to the Pakistan Engineering Company (former Batta Engineering) at Badami Bagh, Lahore for just Rs. 362 million which will reduce its overwhelming liability of Rs. 709 million only to some extent, and the government and the company will be the loser for it.

The buyer is the big gainer as after buying it he got the stipulation, that the land should be used only for industrial purposes, deleted. If this condition had been deleted before the sale of the plot in the key market area with the Badami Auto-Market next door, the government might have got Rs. 900 to Rs. 1,200 million, and the liabilities of the company would have been wiped out altogether. It has also been argued that if instead of the 266-kanal plot being sold as a single piece it had been split into three or four plots, even with the stipulation that it should have been used for industrial purposes only, it would have fetched about Rs. 100 million. Hence, the disappointed candidates for buying have appealed to the PM for cancelling the same and some are proposing to move the courts for its cancellation.

It is to prevent such controversies and deep suspicions that President Leghari called for the kind of privatization that is clear and transparent and done with full awareness that the family silver was not thrown away. He said 'we gave hell to the IJI government when we were in the opposition for its non-transparent methodologies of privatization. Criticism of these methodologies still persists.' And clean and transparent privatization was the answer to it.

A long catalogue of major enterprises awaits privatization, while the IMF is castigating the government for being slow or dragging its feet. Among them are the public sector banks and DFIs [Development Financial Institutions], power and gas enterprises, mining and engineering projects, while the canal system is not to be privatized in the immediate future.

According to the Chairman of the Planning Commission, the pace of privatization is purposely slow, so as to avoid allegations of impropriety. But being slow alone is not enough, as the case of PECO has shown, as too many persons were interested in that precious land which was finally sold so cheaply. The President's comprehensive advice in respect to privatization has to be taken seriously by the government and the Privatization Commission, if the controversy is not to get overheated as more large projects are put on sale.

Source: DAWN, *Economic and Business Review*, Karachi, 20–6 January 1996. This is an edited version of the original article.

Table 8.24
Privatization of State-Owned Enterprises

	Number of units				Value of units sold (Rs. m)	
		of which:			Total	Received
	Total	For sale	Sold	Management transferred		
Commercial banks	5	4	2	2	5,122	2,135
Industrial units	124	105	67	47	8,219	3,896
Automobiles	15	10	8	5	1,043	583
Cement	15	15	11	8	4,658	2,253
Chemicals and ceramics	14	12	5	5	1,030	431
Engineering	12	9	4	4	141	58
Fertilizer	7	5	2	1	457	183
Ghee and vegetable oil	23	23	15	9	626	250
Roti plants	17	17	13	11	99	60
Rice mills	8	8	7	4	165	78
Miscellaneous	13	6	2	0	0	0
Total	129	109	69	49	13,341	6,031

Source: World Bank, *Pakistan: Country Economic Memorandum FY93: Progress Under the Adjustment Programme*, Report No. 11590-Pak (Washington DC: World Bank, 1993), 51.

What was true in the late 1990s, seems truer in 2012, and it seems that two decades later, many of the issues and themes are almost identical. (See the very interesting analysis in Appendix 8.3 on the politics of the privatization process of electricity in Pakistan, analysis which finds that the severe electricity shortfalls of 2008 onwards have their genesis in the deeply flawed privatization policies many years ago—also see Section 8.7 below.)

The result following the renewed vigour to privatize in October 1991 was that, by November 1992, 67 of the 109 units had been issued letters of interest to sell. Of these 67, the management of 49 units had been transferred to the private sector, and an amount of Rs. 6 billion (of the total Rs. 13.3 billion for the 67 units) had been received by the government. One reason why the privatization programme did not develop on the lines that the government hoped it would was that most of the companies put on the 'for-sale' list 'were already technically bankrupt'[65] and hence interest from buyers was low.

The three most coveted sectors to be privatized were the energy sector, telecommunications, and the four commercial banks. By late 1995, the telephone and telegraph sector had been partially privatized and of the banks, the Allied Bank Limited was sold to its employees, and the Muslim Commercial Bank to a private business house. The balance sheets of the banks show that these 'newly privatized banks have rapidly improved their performance'.[66] Two commercial banks, the Habib Bank Limited and the United Bank Limited, and two industrial banks, the National Development Finance Corporation and the Industrial Development Bank of Pakistan, were privatized by the Musharraf government after 1999, as were other important and large public utilities, such as KESC and Pakistan Telecommunication Company Ltd (PTCL), both to buyers from the Gulf states, who were the new owners of United Bank Limited as well. However, a report by the World Bank made the following interesting observations about the banking sector:

> It has been a problem for potential investors to gain access to sufficient information about the quality of the assets of banks. Whereas domestic investors seem to be able to overcome this, robust foreign investors that require the information be presented according to internationally recognized standards are believed to be unsatisfied with quality and quantity of the data. This obstacle will be especially important for Habib Bank, which as the largest financial institution to be privatized probably cannot be sold exclusively to domestic investors. However, the government remains committed to privatize all state-owned banks (except the National Bank of Pakistan).[67]

Interestingly, towards the end of 1995 the United Bank Limited was offered for sale and only foreign bidders remained in the final stages of the process, a move which came in for criticism from concerned economists. Nevertheless, in 2003 the bank was eventually sold to businessmen from the Middle East.

All the evidence seems to suggest that the process of privatization came in for a great deal of criticism in earlier years. The Institute of Developing Economies in Japan identified the following criticism of the process:

> The privatization process was severely criticized by several quarters for the lack of transparency, and the inadequate attention paid to the antecedents of the new management. It was suggested that the bid evaluation procedures were incorrect, and furthermore, inconsistently applied from case to case. It was also alleged that the process suffered from favouritism, as some bidders had privileged access to information and competing bids. In a number of cases, units were transferred to management that had no previous record or experience of running an industrial unit at all; in others the new management had defaulted on its loans from the banking system even though the Commission had stipulated that previous loan defaults would invite an automatic disqualification. The government's response to these allegations, apart from a denial of any deliberate wrong doing, was that speed was of the essence, in order to overcome the inertia generated by vested interest groups.[68]

In another equally critical appraisal of the privatization process, Nawab Haider Naqvi and A. R. Kemal questioned the entire concept of privatization and showed how the process resulted in serious negative consequences.

> We share the view that public and private investments are essentially complementary in nature; and that while private investment holds the greatest promise in areas where productive efficiency matters, its success depends on a well-thought out programme of public investment which first provides an efficient infrastructure. Furthermore, public sector investment in those productive activities where the market 'fails' due to the externalities dominating there, or where no markets exist, is essential to maximize social output notwithstanding the contrary claims of the privatization enthusiasts who attribute every possible economic ill to the so called phenomenon of 'government failure'. Also, recognizing that public sector investment—even in the productive activities—is a fact of economic life in Pakistan, it is essential that privatization should take place where it has the most promise of adding to productive efficiency and economic growth. Indeed, efficiency (and growth) considerations must be seen as the only valid grounds for privatization. And in this context, there is enough empirical evidence in Pakistan to show that changing the locus of ownership from public to private is neither a necessary nor a sufficient condition for achieving any of the avowed goals of privatization; even on theoretical grounds, other objectives for going private—e.g. mobilizing financial resources for the government—had better be achieved by other, more effective policy instruments. *Indeed, the real-world experience suggests that across-the-board privatization, taking place mostly on*

> *ideological grounds, may prove not only self-defeating but positively counter-productive*. Thus, profitable companies can as well be given over to their (not-too-worthy) competitors, exacerbating the degree of concentration in the economy; and the (apparently) defaulting enterprises may in fact be given away to friends of the regime, thus increasing the element of 'crony capitalism'.[69]

Given this extensive criticism, Aftab Ahmad Khan identifies some reasons why there has been so much criticism of the privatization programme:

> An imperative for the success of privatization is the transparency of the process to avoid people's suspicion and ensure their support. All aspects of the privatization exercise must be out in the open and there should be no suspicion of political patronage, corruption, favouritism, or cronyism in implementing it. Unfortunately, this important dimension of privatization has not been given due attention in some privatization transactions and this has resulted in casting doubts on the integrity of those responsible for deciding the choice of parties in the cases. The privatization exercise in our country so far has been suffering from a lack of proper planning. There has been no systematic approach to timing, prioritization, sequencing, classification of units, valuation, and modes of privatization. If one of the purposes of privatization is to broadbase share ownership and expand the equities market, then it is imperative that all sales are quickly followed by successful flotations. A significant proportion of the privatized firms have yet to float equity in the market.[70]

Despite these numerous hard-hitting criticisms of the privatization process in Pakistan, and despite many prescient warnings by many academics and observers, the privatization process under General Musharraf's government, especially in the mid-2000s, gathered a lot of steam, as well as an equal amount of controversy. Some of the comments made in the excellent study of the Institute of Developing Economies in Japan, in 1994, were proven true in 2005–07, when numerous scandals around enterprises expected to be privatized were unearthed. The biggest, of course, was regarding the Pakistan Steel Mills, when it became clear that many of General Musharraf's leading cronies, including the Prime Minister, Shaukat Aziz, may have been involved in underhand dealings. The Chief Justice of Pakistan and the Supreme Court of Pakistan challenged the privatization of the Steel Mills, and exposed a number of issues which revealed corruption of sitting members of the government—see Box 8.6. This decision taken by the Chief Justice and the Supreme Court of Pakistan upset General Pervez Musharraf a great deal and tarred his government with proof of corruption. It was one of the reasons which led General Pervez Musharraf to dismiss the Chief Justice of Pakistan in March 2007, which eventually led to a process of bringing about General Musharraf's downfall.

8.6 The Debate over Efficiency in the Industrial Structure

Following the end of the boom in industrial development in the late 1960s, a number of books and papers were written on Pakistan's industrial performance, and the collective view was that the high growth had been achieved at very considerable costs, and that the entire industrial structure was severely inefficient.[71] For many years, perhaps even two decades, the issue of efficiency in Pakistan's industrial sector, became one of the main academic and research questions for Pakistani economists. The policy instruments that were held responsible for creating this inefficiency rested on the extent and degree of state intervention in distorting prices in the domestic market, which was said to affect the manufacturing sector adversely. As we saw in Chapter 6, much of Pakistan's early industrial and economic growth was predicated on an import substituting industrialization policy, which was the conventional wisdom of the times and was being followed by most young developing countries. The main tools for such a policy consisted of protecting domestic industry by building up trade barriers in the form of tariff and non-tariff restrictions, using multiple exchange rates, and import licensing.

The main work that sparked off the debate over the inefficient nature of Pakistan's industrial structure was undertaken by Ian Little, Tibor Scitovsky, and Maurice Scott,[72] who challenged the then premises of import substitution, protection, and the industrialization process. This study found that amongst the developing countries studied, Pakistan had the highest effective rates of protection (see Box 8.7) in manufacturing. Recalculating the manufacturing sector's contribution to value-added, the authors found that the industrial value-added actually grew at a *negative rate*, and not at 16 per cent as believed. The conclusions of the study were that too much emphasis had been given to the manufacturing sector and, hence, the agricultural sector and manufactured exports had suffered. The policy tools that caused these distortions did so in the following manner:

> The policy tools which were deemed to be responsible for this distortion were the multiple exchange rates, the tariff structure, and to some extent the system of import licensing. The multiple exchange rates meant that exporters imported their inputs at a below par exchange rate and then exported their goods at a higher rate. Also the existence of an export tax, in certain industries such as leather and cotton, meant that there was a disincentive for exports as compared to sale in the local market (where because of protection a preferential rate could be commanded). As for imports, the overvalued exchange rate meant that whereas raw materials and machinery was imported at the official exchange rate it was sold in the market at its full scarcity premium.[73]

Another study revealed that in 1964 about 75 per cent of actual value-added was due to distortions in the industrial

Box 8.6

Corruption, Fraud, and the Privatization of the Steel Mill

Two articles from 2006, when the Pakistan Steel Mill was put up for sale, or privatization, reveal the deep involvement of the most important political leaders of that time.

1. Sabihuddin Ghausi writes:

Within 22 years after its full commercial operations in 1984, Pakistan's only integrated steel mill in the public sector, which has been operating on optimum capacity for at least last three years, was passed on to a consortium of foreign and local investors at a price that is being called "peanuts" and a "no price at all" by employees unions, stock brokers, and independent economists.

Only a day before the bidding for Pakistan Steel, market analysts were putting the price of 75 per cent shares at $1 billion plus. The worth of real estate only (4,546 acres of land on which various units of Pakistan Steel are constructed) was estimated at Rs. 27 billion in March. One of the leading real estate dealers of Pakistan and a top stock broker was approached by the Pakistan Steel authorities to advise them on privatization modalities and valuation of the assets.

The developed land of steel mill was valuated at Rs. 5.5–6 million an acre and the undeveloped land at Rs. 3–3.5 million an acre. Way back in 1974, Pakistan Steel obtained 19,000 acres of land from the Sindh government at 74 paisa per square yard. But the infrastructure developed on this land from taxpayers' money has enhanced the market worth of land at present to Rs. 20 million an acre. This is because there is now 110km metalled road, 70km railway track, a 165 megawatt electric power generation station, a water treatment plant, and a jetty.

But on 31 March, all these assets were given to an investors' consortium for Rs. 21.68 billion ($362 million). Prior to this bidding, there were planted media reports on worn out machinery of the steel mills that now need replacement and revamping. But all credit goes to the management and employees who kept operating their mills at 100 per cent capacity for the last three consecutive years with no major mishap. In 2003, President Pervez Musharraf had announced a bonus for the staff in recognition of their hard work.

The Employees-Management Consortium is offering Rs. 24 billion and is demanding their first right of refusal in the transaction. It is not being heeded either by the Privatization Commission or by the prime minister's office. A stock broker on Thursday offered an immediate payment of Rs. 30 billion for Pakistan Steel.

The consortium that won the bidding includes a Saudi group Tuwairqi, a Russian group M. Magnitogorsk Iron and Steel Works, Arif Habib and Siddique Sons. This consortium offered a bid of $362 million (Rs. 21.68 billion) at a rate of Rs. 16.80 a share. Awais Leghari took the charge as Privatization Minister recently after Dr Hafeez Sheikh quit. Pakistan Steel's privatization was his first assignment and contrary to past practices he immediately issued the letter of acceptance to the successful bidder as he said that he was authorized by the cabinet committee.

The practice is that the successful bid is considered by the Cabinet Committee on Privatization chaired by the prime minister. The Privatization Commission issues letter of approval only after the CCoP has considered all aspects of the successful bid. It was not done in the case of Pakistan Steel. The Privatization Commission did not disclose the reserved or reference price of Pakistan Steel. There is no report as to who was appointed as the financial consultant and who carried out the valuation of the assets.

What makes the deal more intriguing is stone-laying of a 300-million-dollar billet plant of the Tuwairqi group on a 220-acre plot at the Port Qasim. This group is reported to have given $10 million donation for the renovation of Quaid-i-Azam mausoleum. After the Port Qasim billet plant comes into production, with one million ton production line after two years or so, the Tuwairqi group will enjoy almost a monopoly status on a industry that is called "mother industry". The steel industry is the basis of all other industries and if it comes under the control of a group that is alien, it is fraught with all consequences.

For long, Pakistan remained an importer of steel. The powerful lobby of steel importers made it sure to torpedo every effort to set up a steel mills project in Pakistan during the 1950s and 1960s. Steel Mill was called a "white elephant" when set up with the Soviet assistance at a total cost of Rs. 25 billion in the 1970s. There were many hurdles in the implementation of the project, and it was an irony of the events that the late Bhutto had laid the foundation of this project in 1974 and its commissioning was inaugurated in 1981 by the late General Zia.

From 1981 till this day, there were about 22 chairmen. In 1990, as many as six chairmen came and went in Pakistan Steel in a single year. Pakistan Steel's annual procurement of raw material and sale of steel products were worth more than Rs. 30 billion and therefore, all the powerful actors of state—bright stars of civil service and those in uniform—claimed their ounce of flesh from the project. Pakistan Steel is a classic example of inefficiency and corruption of Pakistan's high and mighty but a model of hard work of engineers and workers.

Source: Ghausi, Sabihuddin, 'Pakistan Steel sold at throwaway prices', *Dawn*, Karachi, 7 April 2006.

2. Privatization of Pakistan Steel Termed Biggest Scam

Representatives of more than 50 labour, political, social, and human rights organizations have expressed their strong reservations over the process of the privatization of the Pakistan Steel, and described the sale of the national asset as 'the biggest scam' in the country's history. They were speaking at a one-day consultative meeting held here on Sunday under the auspices of the Labour Education Foundation under the title: *Steel Mill Privatization—A Fraud*. The meeting was chaired by Mr Saleem Raza, Secretary of the LEF.

Speakers on the occasion pointed out that the Rs. 300 billion worth concern had been handed over to the private sector parties at a throw-away price of Rs. 21.75 billion. They claimed that under a pre-planned conspiracy, it had been handed over to some favourite parties. The conspiracy, they

added, had been hatched over the past six years. They alleged that it had already been decided to hand over the PS to a consortium of Russia's Magnitogorsk Iron & Steel Works Open JSC, Saudi Arabia-based Al-Tuwairqi Group of Companies and a local firm Arif Habib Securities whereas the bidding process was for its privatization on 31 March was just an eyewash. They wondered that the auction, which the Privatization Commission had taken one whole year to prepare for, lasted just 30 minutes.

They pointed out that it was only a day before the auction was held, that a $130 million steel factory, Al-Tuwairqi Steel Mills, was inaugurated and a piece of 220-acre land was obtained on rent from the PS for the new concern. They added that 45 million cubic feet gas and 180 megawatt electricity was also sanctioned for the group. They quoted an ex-chairman of mills, Haq Nawaz Akhtar, as saying that the PS would have fetched a higher price even if sold as scrape.

They said that only two days before the auction, the Al-Tuwairqi Group had signed Head of Terms (HoT) with the Sui Southern Gas Company for the supply of 45 million cubic feet natural gas for 10 years and the contract was extendable for another 10 years. They feared that with the PS in its ownership, the group might establish its monopoly on the whole steel industry in Pakistan which would ultimately result in a sharp increase in the prices of iron and steel products, dealing a blow to a large number of local industrial concerns.

The participants said that before the privatizing of the PS, all bank loans outstanding against the mills had been paid off so that the new owners did not have any liability. In this regard, they added, the last instalment of Rs. 2.5 billion Habib Bank loan had been cleared by the government. They said that until 1999, the mill was burdened under Rs. 19 billion loans and its annual loss stood at Rs. 9.326 billion. Later, it was administratively handed over to retired military officers who started sacking workers to curtail the losses. In 2000, the PS had a workforce of 20,533 which had shrunk to 13,080 now.

The speakers said that according to the PS finance director, the mills had generated Rs. 26.1 billion revenue in 2000 and its pre-tax profit stood at Rs. 4.85 billion. They recalled that on Oct 25, 2005, PS chairman Gen. Abdul Qayoom addressed factory workers and announced that in the year 2004–05, the mills had generated Rs. 31 billion revenues and its pre-tax profit was Rs. 10 billion. He had quoted the tax amount paid to the government at Rs. 8.9 billion. The labour leaders pointed out that present value of the PS land, at the current rate of Rs. 20 million per acre, was around Rs. 92 billion whereas the mills' other assets had been estimated at more than Rs. 150 billion. Furthermore, they added, that the new owners had been given an inventory of Rs. 7 billion kept ready in stores, besides finished products worth more or less the same amount.

They said that besides the precious land on the coastal belt near Port Qasim, the other assets of the mills include Steel Ore Plant in Thatta district, water supply plant of 110-mgd, thermal power plant, oxygen power plant, 72-km railway line, 14 locomotives of 800 horsepower each and more than 100 railway wagons. They claimed that only these assets were worth more than Rs. 150 billion.

They said the thermal power plant of the PS supplied electricity to the mills and its township while selling the surplus power to the KESC. Its oxygen plant supplied oxygen to various industrial units and hospitals. The labour leaders deplored that the PS had been sold for an amount which made just two and half years' tax it paid annually. Quoting a statement of the PS finance director, they said the mills had a cash and bank balance of Rs. 12 billion. They revealed that just one month before of the privatization, as many as 80 brand new vehicles were purchased for the mills.

They said that the PS was maintaining a production capacity of 98 per cent and its profit was on the increase every year. They questioned the justification for the sale of the PS when the factory was functioning well, its workers making no major demand and the mills paying over Rs. 9 billion per year tax. They criticised certain political, religious and ethnic organization which had been keeping a discreet silence over the privatization of the mills. The labour leaders lauded the role of labour organizations for raising their voice against its privatization from day one.

They said that on 28 April 2006, the privatization commission had announced a package of Rs. 16.6 billion for Pakistan Steel workers. Considering the package and the cash in hand amounting to Rs. 10 billion, it could be determined that the mills had actually been sold at a loss of Rs. 5 billion. Welcoming the status quo ordered by a full bench of the Supreme Court vis-à-vis the sale of the mills, they demanded withdrawal of the decision to privatize the PS and institution of a corruption case against those involved in the affair.

Source: *Dawn*, Karachi, 29 May 2006.

structure. Due to this protection, according to this study, the manufacturing cost of value-added was increased by an average of nearly 300 per cent compared to what the cost would have been had there been no protection.[74]

The analysis from the work on protection, distortion, and inefficiency in the industrial sector in the 1960s suggests that the following principal distortions were created: the neglect of agriculture at the cost of industry; excessive emphasis on the manufacturing sector, resulting in poor export performance; a distorted sectoral distribution in industry (i.e. between the consumer, intermediate and capital goods industries); and a disincentive for technical change, as the existing structure would not have encouraged much development in technology because returns were already very high.[75]

However, all the evidence presented in the earlier chapters, particularly Chapter 6, shows that none of the alleged consequences followed. In fact, one sees the reverse, with agriculture showing very high rates of growth throughout the 1960s at a time when there was supposed to be considerable anti-agricultural bias in policy. We also see that, despite the import substituting strategy, there was actually no distortion of the sectoral distribution in industry, and although the consumer goods sector showed high growth, as it should

Box 8.7

How Does One Measure Protection and Inefficiency?

Viqar Ahmed and Rashid Amjad discuss the methodology used in the calculation of effective rates of protection, and show how we come up with such concepts as a 'negative' value-added by industry.

> Basically, these exercises calculate the cost of inputs and the value of outputs first at 'market' or 'domestic' prices, which include protection and other subsidies, and compare these with the costs of inputs and the value of outputs of similar (or nearly so) goods at what they would be in the 'world' market or 'trading prices', i.e. if they were bought and sold in the open world market. The rate of effective protection is then defined as the per cent of value-added due to protection.
>
> A simple version of this concept may be shown as follows:
>
> Value-added in industry 'i' at 'market' or 'domestic' prices $= w =$ sale value of output minus cost of inputs
>
> Value-added in industry 'i' at 'world' or trading prices $= \hat{w} =$ sale value of output minus cost of inputs
>
> Effective rate of protection of value-added due to protection $= \dfrac{w - \hat{w}}{w}$
>
> Let us illustrate by taking three different cases. Suppose value-added at 'domestic' prices is a hundred but at 'world' prices is only ten. Then value-added due to protection or the effective rate of protection is 90 per cent. In the second case, suppose value-added at 'domestic' prices is again a hundred but at 'world' prices is negative, i.e. sale value of output is less than the cost of inputs (say minus ten). In this case then, as the rate of effective protection is > 100, it would imply *negative value-added* by that industry. What this means is that rather than add value to the inputs it uses, it actually 'loses' value when we evaluate the inputs and outputs at world prices. Finally, suppose value-added at 'world' prices is greater than value-added at 'domestic' prices, then this would indicate that the protection system is discriminating against the output of that industry (for example, tariffs on inputs exceed tariffs on output).

Arshad Zaman also measures EPR as follows:

> The concept of effective protection was designed to be a summary measure of the degree of incentive provided to an industry, and is usually measured in terms of Effective Protection Rate (EPR), defined as the difference between value-added at domestic prices (VAD) and that in world prices (VAW), expressed as a ratio to the latter. Thus:
>
> $$EPR = \frac{VAD - VAW}{VAW} = \frac{VAD}{VAW} - 1$$
>
> In practice, a number of assumptions are made in calculating EPRs which should be borne in mind. First, the calculations assume that domestic producers are taking full advantage of the protection offered by the tariffs. Where there is significant smuggling, this is clearly not the case, and the degree of protection is overestimated, perhaps by a wide margin. Similarly, where prices are controlled, the producers are unable to exploit the potential advantages of protection. Second, survey data on which EPR estimates are based typically exhibit under-reporting of production, imparting again an upward bias to protection estimates. Third, price comparisons based on reported CIF import prices reflect underinvoicing of imports, and consequently lead to overestimates of implicit EPRs. Finally, the substantial variation in production coefficients across firms makes precise policy formulation difficult. Due to these problems of interpretation and estimation, the actual level of effective protection should not be taken too seriously, the ranking by industry is more relevant.

Sources: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 211; Zaman, Arshad, 'Effective Protection and Performance of Public Enterprises in Pakistan', *Public Enterprise*, 1986, vol. 7, no. 1, 43.

have under these circumstances, the intermediate and capital goods sectors also showed very high rates of growth.

The evidence that total factor productivity growth and growth in labour productivity were considerable also confirms that there was substantial technological dynamism in the industrial sector. As Meekal Ahmed argues:

> There is little support for the arguments, that the rise in the productivity of labour in Pakistan is to be explained mainly in terms of a strong factor substitution effect combined with insufficient innovations, or that high effective rates of protection are symptomatic of high costs. On the contrary, the present analysis shows that manufacturing industry in Pakistan has, in general, demonstrated a high capacity for technological adaptation and innovational assimilation, a result which is substantiated by the important role that technical progress and increasing returns play in explaining the pattern of labour productivity advance. Cost reductions were, however, not adequately reflected in price reductions in oligopolistic markets. Hence the fact that prices remain relatively stable in the more dynamic sectors of production means that the potential for changing the pattern of production in response to the unequal incidence of productivity tends to operate much more weakly.[76]

Asad Sayeed concludes that 'there seems to be no conclusive evidence on the existence of technological ossification or other related inefficiencies in Pakistan's manufacturing

sector during the decade'.[77] The reasons why the work by Little, Scilovsky, and Scott and by others consistently came up with the conclusion that Pakistan's industry was inefficient are discussed below.

Another criticism launched against the industrial policy of the 1960s in Pakistan relates to the hypothesis that despite having scarce capital, the incentive structure was such that there was underutilization of capacity, and hence an expensive and scarce resource was being wasted. This argument ran as follows:

> Little et al. argue that in an environment where the relative cost of capital is artificially low, there will be a tendency towards over-capitalization. Also, other government controls, primarily in the form of import licensing, further exacerbate the problem of capacity utilization as the import of raw materials is linked to the acquisition of these licences as well as the availability of foreign exchange. Particularly in the case of Pakistan, the argument goes, since import licences for raw materials were linked to installed capacity, this created a tendency to install new plants in order to avoid raw material bottlenecks. To the extent that this problem exists, as the evidence put forth by Hogan and Winston suggests, this is unfortunate as the primary problem of development is deemed to be scarcity of capital and here we have a situation where there is idle capital.[78]

Asad Sayeed, examining this proposition with respect to Pakistan in the 1960s, concedes that while the rate of utilization of capital was increasing over time, the absolute level was still low (see Table 8.25). However, examining the data, he concludes that it was structural constraints—such as the inadequacy of demand, infrastructural bottlenecks such as power and transport, scarcity of skilled labour and problems of assimilating foreign technologies—which were primarily responsible, rather than the constraints pertaining to the misallocation of resources as the neoclassical orthodoxy would have us believe.[79]

Akbar Noman has argued that the claims made by Little et al. regarding inefficiency are 'highly misleading'. He argues that these authors 'derive their estimate of value added from the calculations of effective protection rates made for Pakistan. These suffer from the familiar problems of data and interpretation, *though quite possibly more acutely for Pakistan than most cases*'.[80] In the case of Pakistan, the calculation used to establish inefficiency employed figures for value added at world prices that were understated, and effective protection rates that were overstated. Akbar Noman also shows how effectively and pervasively underreporting of output by firms in Pakistan takes place by 'very considerable margins'.

Unfortunately, a number of important works on Pakistan have taken for granted the evidence and data provided by the numerous studies conducted after the 1960s, without questioning the methodology or data sources used. This has helped perpetuate the myth that Pakistan's industrial structure was very inefficient. Viqar Ahmed and Rashid Amjad also fall prey to this, arguing that

> the evidence put forward clearly showed the basic 'inefficiency' of the industrial structure, which had emerged by the mid-sixties, when compared to 'world prices'. Although it can be argued that any country starting the process of industrialization behind tariff barriers would show considerable 'inefficiency' in terms of 'world prices', there is still no doubt that the industrial structure in *Pakistan was extremely inefficient even after fifteen years* of industrialization. The reason for this was the incentive structure, created for the manufacturing sector, which put little or no pressure on the producers to cut down on costs especially capital costs of production. Also, little attention was given to the question of whether it was really beneficial for the country to set up an industry which would never really ever become internationally competitive and whose value added would in the extreme case continue to be negative even after many years of production behind highly protective barriers.[81]

However, a number of leading scholars have critically evaluated the data and evidence, and have come up with a re-evaluation of the state of inefficiency in the 1960s. Akbar Noman argues that 'the inefficiencies of Pakistan's industrialization during the 1950s and 1960s *have been much exaggerated*. They were still considerable but not so great as to rule out any justification of them as the price of rapid growth, at that stage of Pakistan's industrial development'.[82] He believes that 'the argument that high protection in the

Table 8.25
Capital Utilization in Manufacturing Industries of Pakistan (%)

	1960/1	1965	1965/6	1967/8
Rates of capital utilization				
0–20	60.98	18.57	36	16.67
20–40	29.97	71.43	44	36.67
40–60	4.88	2.86	8	23.33
60–80	4.88	4.26	12	18.33
80–100	0	4.26	0	5
Average capital utilization rates by end use				
Consumer goods	47.87	62.61	57.80	68.13
Intermediate goods	21.60	66.45	62.07	54.42
Capital goods	25.33	39.11	30.23	55.76
Average level of capital utilization				
Simple average	21.82	32.04	31.44	41.33
Weighted by capital stock	41.67	59.02	48.65	62.65

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD thesis, University of Cambridge, 1995, 63–4.

early years affected mainly the rate rather than the pattern of industrialization would appear to be correct'.[83] The work by A. R. Kemal and Meekal Ahmed also substantiated many of these findings, as did the excellent work by Asad Sayeed.[84] Asad Sayeed concludes his evaluation of the efficiency debate by the very important observation that 'the allocative efficiency losses that might have occurred as a result of state intervention appear to have been compensated by dynamic efficiency gains that accrued'.[85]

Another line of argument that emerged regarding the efficiency/inefficiency issue was related to industrial concentration that was excessive, and which was considered responsible for the inefficiency and deceleration in Pakistan's growth in the late 1960s.[86] However, the report by the Institute of Developing Economies concludes that 'the argument of industrial concentration provides no economic reason per se for either falling investments or inefficiency in the manufacturing sector of Pakistan in the 1960s'.[87] A. R. Kemal also believes that by the end of the 1960s much of Pakistan's manufacturing industry could 'survive without protection. The protection has resulted in higher profits and is not a result of inefficiency.'[88] The evidence on growth of total factor productivity and labour productivity, as seen in Chapter 6, shows that even though the industrial structure was concentrated, it was able to use resources efficiently.[89]

Most of the work on the industrial sector of the 1960s has tended to argue that the industrial policy was protectionist and distortionary, giving rise to deep-rooted inefficiencies in the industrial structure, which later carried on into the 1970s and caused the industrial crisis. Interestingly, a World Bank (1993) study on Pakistan has argued that the three industrial subsectors of chemicals, engineering, and textiles face domestic resource costs that are 'close to international standards and are *thus not operating particularly inefficiently*'.[90]

Table 8.26 shows the effective rates of protection and the domestic resource costs (DRCs) of some industries—a DRC coefficient above 1 indicates inefficient production conditions. The DRCs show that the textile industry is the most efficient industry within the manufacturing sector, and chemicals and engineering are only slightly inefficient. The study also argues that the 'current average effective protection levels *seem moderate*, but conceal vast differences among product groups'.[91] In the chemical subsector, industrial chemicals, fertilizers, and synthetic fibres are highly protected, while in engineering, basic metals, and mechanical products enjoy high effective protection. The electrical and electronic products are negatively protected, and protection levels for cotton spinning and made-ups are low.

While much in terms of industrialization policy and strategy changed in the 1990s and after, compared with the

Table 8.26
Impact of Trade Reform on Effective Protection and Profitability

	Pre-reform			Post-reform	
	DRC	EPR	Private returns	EPR	Private returns
Chemical					
Paper and paper products	0.86	–8	12	24	26
Basic industrial chemicals	1.69	70	9	1	–5
Fertilizers	1.08	23	14	3	9
MMF	1.30	29	9	0	3
Other chemical products	0.76	10	27	19	32
Rubber and plastics	1.03	19	13	32	18
Glass and ceramics	1.03	6	11	20	15
Subsector	1.04	20	14	13	12
Engineering					
Basic metals	1.32	25	7	48	14
Metal products	1.10	19	12	11	10
Mechanical machinery	1.25	58	19	24	9
Electrical machinery	0.76	–13	14	30	31
Electronics	0.92	–31	2	16	16
Transport equipment	1.07	–1	7	24	13
Subsector	1.07	12	11	27	15
Textiles					
Cotton spinning	0.72	–5	20	12	26
Weaving and finishing	1.22	45	16	22	10
Cotton made-ups	0.87	9	18	3	16
Woollen products	2.20	93	6	17	–5
Jute products	1.07	38	16	21	12
Subsector	0.92	13	17	12	16

Source: *Pakistan Country Economic Memorandum FY93: Progress Under the Adjustment Program*, Report No. 1590–Pak (Washington DC: World Bank, 1993), 48.

1960s, it is likely that, had the extreme extent of inefficiency identified by Little et al. actually existed, the more recent picture presented by the World Bank would have been less positive. Had Little et al. been correct, much more inefficiency would have carried over into the 1980s and 1990s than actually did. While the data, calculations, and methodology are fraught with numerous serious problems, one may nevertheless conclude that the claims of the extent of inefficiency in the industrial sector in Pakistan have been grossly exaggerated (see Box 8.8 on Total Factor Productivity in Pakistan, and Appendix 8.4 in the first edition of *Issues*).

8.7 The Energy Crisis

Perhaps the one single factor which had an impact on the industrial sector in particular, as well as the economy overall, from 2008 onwards, was the energy crisis in Pakistan. Estimates suggested that between 2–3 per cent of GDP was lost each year on account of power shortages—See Box 8.9. While electricity is now a major component in most economic activities, and hence all economic activities have suffered, but in some sectors—such as textiles and the power looms sector—the energy crisis has had a particularly severe effect. Newspaper and television reports have been highlighting the plight of the industrial sector, and for months on end in 2012, there was mass rioting across much of Pakistan, particularly in the Punjab, where most of Pakistan's industry, particularly its small-scale sector, resides. This section only raises some key issues around the power crisis and is not a comprehensive analysis of the problems affecting energy generation in Pakistan—see Box 8.10 on the politics of the energy sector, and Appendix 8.3 for a more comprehensive analysis of issues in the power sector.

In a report released in early April 2012, the Asian Development Bank stated that the absence of energy was the main constraint for economic growth, and suggested that better load-management was required to minimize commercial losses. The ADB estimated that 'losses arising from power and gas shortages held down GDP growth by 3–4 percentage points in FY2011 and FY2012. Improved management of power resources could ameliorate predictability of load-shedding to allow the private sector to better schedule work and minimize costs'.[92] Abid Burki and his colleagues in their assessment of the industrial sector in Pakistan, argued that, 'the ongoing energy crisis has crippled Pakistan's industry and economy. A conservative estimate puts the loss to industry at 13 per cent of total manufacturing sales or nearly Rs. 130 billion per annum. The energy crisis is hitting the industry at multiple levels: energy tariff increases are forcing businesses with low margins and those businesses with low margins and those who are unable to generate their own power (e.g. SMEs) to close down; unannounced load-shedding and voltage fluctuations damage machinery worth millions of dollars; unavailability of electricity harms productivity of workforce'.[93]

Akmal Hussain very succinctly summarizes the main issues in the energy crisis in Pakistan in 2012. He writes:

> The core of the power crisis lies in three facts: (a) As much as 82 per cent of total electricity production is now oil-based when oil prices are astronomically rising. By contrast, a decade ago, only 50 per cent of electricity output was fuel-based with the remaining 50 per cent coming from much cheaper hydroelectric power. Consequently, the average cost of electricity has become so high that the government simply does not have the fiscal capacity to provide the subsidy necessary to supply electricity at a price which most consumers can afford. Indeed, increasing oil-based electricity would involve doubling the price of the additional supply. (b) A related problem is billions of rupees of unpaid electricity bills by the provincial governments, semi-autonomous corporations, and federal government departments. The recovery of this shortfall prevents the government from paying its dues to the independent power producers who are then forced to cut back production. (c) Institutional weakness combined with obsolete transmission technology results in theft and transmission losses amounting to 30 per cent of the total electricity generated. The long-term solution is to invest in hydroelectric power. In the short-term, apart from improving recoveries, an annual foreign aid of about five billion dollars may be required for the next five years to achieve full capacity utilization and supply electricity at an affordable price. This means shifting our policy of confrontation with the West to cooperation.[94]

The electricity shortfall in Pakistan was around 5000 MW a day in April 2012 at a time when the full load of summer had not set in, but had been even higher, at 7500 MW in October 2011. This shortfall meant that power outages varied from between 6 hours a day in large cities to almost double that, and have been close to 16–18 hours in rural areas. This has meant that not only have domestic users not had their needs met, but importantly, the main commercial and industrial users of electricity have been denied access, resulting in the loss of economic activity. While the large metropolises comprise of large domestic consumers, it is the textile and power looms sector, and most businesses dependent on crucial power supply, which have suffered most. Most of Pakistan's economic activity takes place in the largest province of the Punjab where such industry is located. Apart from Karachi, the largest city with 20 million inhabitants, power riots have spread across the industrial towns of the Punjab. Given Pakistan's political structure at that time 2011—the Punjab provincial government and Pakistan's federal government belonged to opposing political parties—the electricity shortfall had also been used to gain political mileage. According to the ADB, the cost of power generation in the country has escalated by 'almost 40 per cent in the 2 fiscal years ending FY2011. Despite steep increases in tariff and fuel price adjustments, customer tariffs remain below cost recovery, requiring large government subsidies to keep the system operating'.[95]

Box 8.8

Productivity Growth in Pakistan: Significant but not Sustained

The Panel of Economists created by the Planning Commission of the Government of Pakistan in 2010, in its overall evaluation of the economy, also looked at Total Factor Productivity (TFP) in Pakistan.

One of the fundamental questions that arises across all economies is how much of economic growth is caused by growth in physical and human capital and how much is caused by factors such as technology and institutional change. Though there is little doubt about the positive impact of increased physical and human capital on growth, most economists feel that sustained high growth is dependent on sustained technological and institutional growth. Based on the assumptions of constant returns to scale and competitive factor markets, one can calculate the growth rate implied by the rates of change in physical and human capital and find the deviations of the actual growth rate from this implied growth rate. These deviations are the result of technological and institutional change and are called growth in total factor productivity (TFP).

This Box looks at the productivity growth rates for the Pakistani manufacturing sector, the Pakistani agricultural sector and the Pakistani economy as a whole. The reason why a disaggregated analysis is meaningful in the context of a developing country like Pakistan is because of the prevailing view that agricultural productivity growth is significantly lower than manufacturing productivity growth. This has extremely important policy implications: First, if agricultural productivity is perceived to be perpetually lower than manufacturing productivity, then policymakers will tend to bias policies and incentive structures towards manufacturing (which has generally been the case in Pakistan). Second, if agricultural productivity is perceived to be lower than manufacturing productivity, then research resources and technology adoption will be more heavily directed towards the manufacturing side.

TFP growth over the period 1985 to 2005 average 2.48 per cent per year in the manufacturing sector A detailed breakdown of the growth in the manufacturing sector is provided in Tables IV.1 and IV.2. As Table IV.1 shows, the average growth rate of large scale manufacturing output is 7.8 per cent between 1985 and 2005. During this same period, the capital stock grew at an average of 6.6 per cent a year, the labour force grew at 3.5 per cent per year and TFP grew at 2.4 per cent per year. Table IV.2 presents an interesting breakdown of the components of manufacturing sector growth. 56 per cent of total large scale manufacturing sector growth was due to growth in capital stock, 15 per cent was due to growth in labour and 29 per cent was due to growth in TFP. Thus, it can be clearly seen that manufacturing sector growth has been driven primarily by increases in capital and not increases in productivity.

Figure VI.1 shows the high correlation of manufacturing sector growth with changes in productivity. As can be seen, periods of high productivity are accompanied by high growth and periods of low productivity are accompanied by low growth.

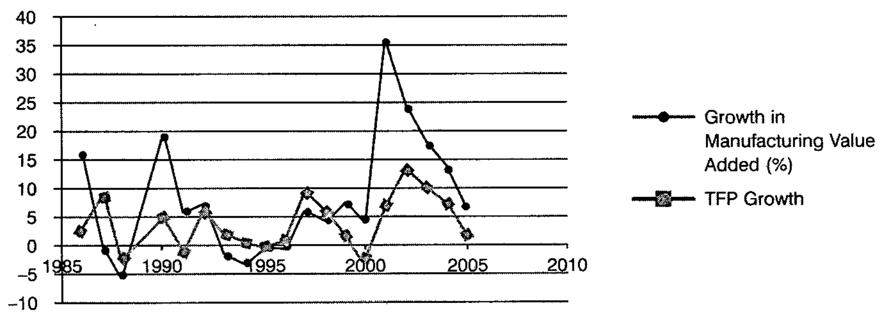
Table IV. 1: Average Growth Rates in the Pakistani Large Scale Manufacturing Sector, 1985–2005 (%)

Large Scale Manufacturing Output	Large Scale Manufacturing Capital Stock	Large Scale Manufacturing Labour	Total Factor Productivity (TFP)
7.6%	6.6%	3.53%	2.4%

Table IV. 2: Components of Pakistani Large Scale Manufacturing Sector Growth, 1985–2005 (%)

Growth on Capital Stock	Growth in Labour	Growth in Total Factor Productivity
56%	15%	29%

Figure VI. 1: Pakistani Manufacturing Sector Output and Productivity Growth



Final Report of the Panel of Economists, *Medium Term Development Imperatives and Strategy for Pakistan* (Islamabad: Planning Commission, Government of Pakistan, April 2010), 174–6.

Box 8.9

Losses Due to the Power Crisis

Mushtaq Ghuman presents an analysis of the 2011/12 power crisis and shows how this had an impact on the economy.

The country is losing up to three per cent of its GDP because of power shortages which may increase if this trend persists, a report compiled by the National Electric Power Regulatory Authority (Nepra) showed.

In its annual reports 2011–12, the power sector regulator said that the energy crisis had its roots in a number of issues, including lack of integrated energy planning and demand forecasting; imbalanced energy mix with a heavy reliance on oil and costly imports; non-utilization of vast indigenous resources such as coal and hydel; lack of effective project structuring, planning and implementation of viable projects.

According to the Pakistan Electric Power Company (Pepco), the shortfall of power in Pakistan on an average is more than 5000 megawatts. Many power plants were generating electricity at half their capacity because of fuel-related issues. The severity of power outages, it said, was persistent.

Violent protests over power cuts have become a routine in different parts of the country, besides affecting industries and businesses. Unpredictable outages, it said, had also affected industrial output because of which export of goods suffered, subsequently resulting in job cuts for industrial workers.

According to the report, over the past five years, natural gas allocation for the power sector was reduced and the use of furnace oil for power generation increased considerably. The country spent billions of dollars every year on the import of crude oil and deficit petroleum products. This has increased the cost of generation, raising circular debt, leading to higher power rates. Furthermore, the power system was afflicted by corruption and inefficiency.

It said that the situation had aggravated to such an extent in the PEPCO—the entity entrusted with the task of managing the transition of Wapda's transition to a corporate, commercially-viable and productive entity—that the survival of the Generation Companies (GENCOs), the National Transmission and Dispatch Company (NTDC) and the ex-Wapda Distribution Companies (DISCOs) is at stake.

On the one hand, there was shortage of power and on the other, Oil Marketing Companies (OMCs) and Gas Supplying Companies are not getting payments from NTDC and Discos, making it difficult for OMCs to arrange fuel for power plants. Again, Independent Power Producers (IPPs) minimized the supply of electricity despite the available capacity on account of non-payment of their dues by the Pepco and the Water and Power Development Authority (Wapda). All these factors have led to a situation where it is virtually impossible to attract new investment.

Karachi Electric Supply Company Limited (KESCL), mainly composed of various thermal power plants, has not been able to run its power plants at full capacity because of the declining supply of gas. The KESCL has not been able to arrange the required quantity of fuel from the market to operate these plants on alternative fuel due to its weak liquidity position directly linked to the circular debt crisis owing large payments to the PEPCO and the fuel suppliers.

KESCL has, at times, not produced at peak capacity, to avoid purchasing expensive furnace oil, preferring instead to purchase cheaper electricity from the PEPCO and NTDC system. This was clearly a downside of privatizing monopolies as fully integrated entities in an environment where the market was not competitively structured. The dispute between the management of the KESCL and its staff labour union has further added to the problems.

However, the new management of the KESCL has clamped down on the rampant culture of power theft in Karachi and efforts to increase the older plants' capacity are beginning to bear some fruit Besides circular debt, the other major issues hindering the overall operations of the PEPCO and the KESCL systems include gas depletion, load shedding, deteriorating fuel mix, and losses.

Gas Depletion: Historically, thermal power plants use two types of fuels namely indigenous natural gas and imported furnace oil. Initially, the power sector got the lion's share in the allocation of natural gas. However, the gas companies did not sign long-term agreements with the public sector utilities and later on, the allocation of gas to the public sector plants was allocated on an 'as and when available' basis. This pattern continued for a considerable period up to the mid eighties. However, with the passage of time, natural gas became a scarce resource because of major use in the domestic, fertilizer, and transport sectors. Lately, the allocation of natural gas for the power sector has declined to a dangerous level which is hardly sufficient to produce electricity matching the installed generation capacity.

The severity of the issue can he gauged from the fact that under the Power Policy 2002, only four IPPs were set up and that too with an annual commitment of gas for nine months. With the Gas Supply Agreements (GSAs) for these four IPPs expiring and the gas companies not willing to extend or renegotiate the same any more, it is very likely that these would he operating on alternative fuel (i.e. HSD) which will further deteriorate the thermal energy mix of the country.

Over the years, the percentage of electricity generation using natural gas has declined. This trend requires a complete reversal In order to keep the tariff reasonable for end consumers. Taking stock of the situation, the Government of Pakistan was not only exploring the possibility of importing Gas from regional countries including Iran and Tajikistan but also tapping other sources of Gas including LPG and LNG for the power sector. The government, through the Sui Southern Gas Company Limited (SSGC), was contemplating import of LNG to find a suitable alternative fuel to replace natural gas.

Load Shedding—Every segment of society including households, commercial, industrial, and agriculture is heavily dependent on the usage of electricity. Pakistan is facing an acute electricity shortage with the public being forced to stay without electricity for more than 9–10 hours in some cities and around 16–18 hours in many rural areas. It is estimated that the country was losing two to three per cent of its GDP due to power shortage, which may increase if the shortages persist. The deepening power crisis has forced many businesses to close down.

In order for the price of electricity to be affordable, it is imperative to have a proper energy mix. Over the years, the generation mix, which was earlier in favour of cheap hydel power, has deteriorated substantially. At one time, the contribution of hydel energy was around 65% in the overall energy mix of the country, which has now reduced to around only 29.15% totally disturbing the energy mix leading to an increase in the consumer end tariff. At present, the energy mix is heavily skewed in favour of thermal generation, which is mostly based on imported furnace oil. This not only leads to higher inflation but also jeopardises the competitiveness of our industry in the international market due to deteriorating natural gas allocation for the power sector, it is expected that the energy mix will deteriorate even more, further increasing the tariff for the end consumer.

On account of depleting gas reserves, most of thermal power plants being installed use imported furnace oil as the primary fuel, causing not only huge burden on the foreign exchange reserves, but also making the overall tariff for the end consumers more sensitive to price changes in the world oil market.

The report further states that the twin issues of adding power-generating capacity and stemming transmission and distribution losses on account of pilferage is a daunting task for the Government saddled with losses running into billions of rupees due to power theft during transmission and distribution and billing inefficiencies. As agricultural power supply was unmetered, many utilities wrote off all losses from the transmission and distribution as agricultural consumption. Utilities faced losses due to unmetered and unaccounted for sales.

Source: Ghuman, Mushtaq, 'Acute power shortages: three per cent GDP being lost: Nepra', *Business Recorder*, Karachi, 21 November 2012

Box 8.10

The Politics of the Energy Crisis in Pakistan

Ihtasham ul Haque gives a detailed analysis of the energy crisis in Pakistan, prevalent since 2008.

The government for the past four years has failed to come up with any short-, mid-, or long-term strategy to deal with the energy crisis. Six power plants remain shut; HUBCO and KAPCO are forced to generate half of their capacity, while up to 15 grid stations are also not working. Officials concede that the current month's 8500 MW electricity shortfall would hit an alarming 10,000 MW early next month. The independent power plants (IPPs) produce 6,250 MW, but due to non-payment of their dues, a whopping circular debt of $4.0 billion has been created, resulting in lower power generation.

Energy demand over the next five years is expected to grow by more than 7.0 per cent per annum. Forecasting, carried out by the Private Power and Infrastructure Board, up to year 2020 reveals a future demand of approximately 45,000 MW against a meagre supply of 28,000 MW, showing a shortfall of around 18,000 MW.

Back ground discussions with concerned officials reveal that the power sector, which unfortunately relies heavily on thermal generation, desperately needs around Rs. 3.0 billion a day to buy fuel, whereas collections from consumers amount to less than Rs. 1.0 billion. President Asif Ali Zardari ordered to provide Rs. 8.0 billion to the IPPs when power riots triggered in Punjab a few months ago and similar instructions given to the federal government for payments of another Rs. 8.0 billion to these power producers.

The president had instructed Petroleum Minister Asim Hussain to immediately rectify the situation, but he only ended up stopping some gas supplies to fertilizer companies and diverting it to the power sector. Hussain seems to have little idea of how to resolve the energy crisis and insists that without a long-term plan, the problem of power outages cannot be resolved. Privately, he puts the blame of the energy sector mess on politicians. The government has displayed a total disregard towards the appointment of professionals on specialized slots. The handing over the energy portfolio to Hussain—a medical doctor and former physician of the president in 2008—seems a befitting case in point. Appointment of Khalid Saeed as chairman NEPRA is another example. Some officials of the Ministry of Water & Power maintain that it is impossible to contain load-shedding until the 1600MW Neelum-Jehlum hydro project gets completed in 2016.

Apart from the immediate issue of circular debt, lack of maintenance of the government-owned power generation plants, line losses due to staggering power thefts, an inappropriate energy generation mix with less than 1.0 per cent share of coal and system losses coupled with collection inefficiency remain the major causes of the energy shortfall. In this regard, Finance Minister Hafeez Sheikh and Law and Justice Minister Farooq Naik are believed to be ardent critics of ministries of petroleum and water and power. They remain adamant that these ministries should work out fresh plans to accelerate recoveries from private consumers and the government departments as well as from the provinces, FATA, and AJK. The concerned officials maintain that without the recovery of Rs. 378 billion, the issue of load-shedding cannot be resolved.

Power shortages continue to become overwhelmingly huge as 70 per cent demand remains unmet. The power generation has reportedly dropped to a mere 9,400 MW against the total demand of 17,400 MW. Many blame it on the diversion of 680 MW to the KESC out of the total generation. The major reliance currently remains on IPPs as the rental power plants

with a capacity of 2200 MW only forecast a generation of 1450 MW owing to corruption and irregularities, blatantly pointed out by the Asian Development Bank (ADB), and eventually spawned a paltry 67 MW fleecing the tax payer of Rs. 120 billion in the process.

The 180 degree reversal of power generation mix of 70 per cent hydel and 30 per cent thermal in the 1990s is a classic example of short-sighted vision of our rulers and emphasis on 'project-oriented' and 'quick-fix' solutions as opposed to anything that could be called long-term or 'goal-oriented'.

Another aspect of the intellectually bankrupt policies is the politicisation of projects of national interest. Arshed Abbasi, an expert on water and power issues, alleges that abnormal and deliberate delay in the hydropower projects and wastage of heavy foreign exchange on RPPs [Rental Power Projects] are the biggest crimes of the Water and Power Ministry. He says that hydel power generation is being discouraged due the unprecedented influence that the thermal lobby exerts over the government.

Arshad mentions that the Board of Investment lured a foreign investment of $800 million in 2008 for the installation of a 600 MW hydropower plant, which would have sold electricity at Rs. 4.0 per unit. "But this was sabotaged by the advisor to the ministry of water and power."

The government has allocated Rs. 70 billion in the new budget for the Benazir Income Support program (BISP) which has room for a drastic curtailment to divert the much-needed funds for the IPPs. But this is now impossible as BISP is a political programme aimed at luring voters in the next elections. Additionally, Rs. 27 billion allocated as part of discretionary funds of the prime minister could also be diverted to the IPPs. Furthermore, Rs. 184 billion kept for the power subsidy can also be augmented, while cutting down huge expenses of the president and prime minister houses.

The other short term solution to the energy crisis is the removal of Rs. 400 billion circular debt and collection of Rs. 378 billion outstanding dues from the public and private electricity consumers. In addition, Rs. 166 billion are payable by the provinces and if the government could recover this amount, it could be channelled to IPPs to increase their generation to 60/70 per cent of their installed capacity.

Long-term solution lies in the early undertaking of bigger hydro projects such as the 4500 MW Bhasha Dam, which faces various issues including that of resettlements. Even if commissioned today, the project would take five years to complete. The government has also been advised by experts to convert expensive fuel-based plants into gas-fired, which would be less expensive despite importing gas. Existing thermal power plants should also be converted to coal on the fast track basis. An estimated $7–8 billion can be saved annually if the thermal plants are converted to coal from furnace oil.

Pakistan's long-term energy needs can only be met with judicious planning with regards to harnessing all the available energy resources. The country has immense power generation potential with 180 billion tons of coal reserves in Thar. Besides that, production of clean nuclear energy is also a reality since Pakistan possesses enormous human resource and expertise in this sector, which has more than 47 'safe' reactor years of operational experience. The country's 89 per cent hydro-power potential also remains untapped. Only 6,720 MW out of approximate 60,000 is being utilized, according to open book sources. Lying in the Sun Belt and having natural wind corridors in Sindh, the potential for renewable energy resources is also immense.

Source: Excerpted from Haque, Ihtasham ul, 'Powerless Pakistan', *Money Matters*, *The News*, Karachi, 25 June 2012.

Sources for Pakistan's electricity generation are primarily oil (around 38 per cent in 2010), hydel, and natural gas (both around 30 per cent). Domestic users constitute almost half of all consumption, the industrial sector (27 per cent), and agriculture (13 per cent). The problem of the shortfall, at one level, seem as simple as a supply/demand gap, related to issues of imported oil prices, and seasonal (and increasingly decreasing) water flows. However, given issues particular to the production, distribution, and pricing of energy in Pakistan, they are somewhat complicated.

Broadly, the reasons for Pakistan's recurrent energy crisis rests on the fact, that like much else of the infrastructure, in recent years, supply has outstripped demand and new developments and planning have not been able to to bridge the gap. Other complications arise as a consequence of energy losses in the power system, at the generation, transmission, distribution, and consumption stages. Transmission and distribution losses and theft alone, account for more than 30 per cent of the production of many of the larger distribution companies, (DISCOs) most of which are publically owned, either fully or partially. A vicious 'cycle of circular debt'—see Box 8.11—has emerged, where these DISCOs have to pay for electricity to the generation companies, who in turn have to pay their oil and input suppliers, but since the DISCOs receive payments intermittently and not fully, they resort to borrowing; due to the high interest costs and other reasons, debt rises, and accumulates, the government steps in when the crisis is aggravated, but the cycle breaks again. The circular debt, currently at Rs. 400 bn (USD 4.4 bn or 2 per cent of GDP), has repercussions on the fiscal state of the overall economy, as well, and given Pakistan's political economy, numerous state departments and institutions—such as the Supreme Court, Pakistan Railways, the Rangers, the ISI—avoid or delay paying their electricity dues, adding to the fiscal burden. The ADB in its report also stated that 'for every unit of power sold, there is a loss to the sector reflected in the form of subsidies. An outstanding accumulation of Rs. 220 billion was carried into FY2012, and an additional financing of 1–1.5 per cent of GDP is likely to be required in FY2012'. In addition, corruption and policy failures with regard to management and transparency—in the previous government's policy of importing 19 Rental Power Projects—have been identified by the Supreme Court, reversing some policy initiatives in the past to address the power problem.

Box 8.11

The Power Sector: A Vicious Circle of Debt

I. Faisal Bari looks at the issues around the circular debt which has accumulated in the power sector and a theoretical insight into what exactly constitutes circular debt when it comes to electricity, and some practical simple ways to get out of it

The dynamics of circular debt are not difficult to understand. When a good/service is sold/provided, the good/service moves from manufacturer or supplier to customer, and money, the price for the good/service, goes from the customer to the supplier. At each stage of production, the seller needs to be compensated as he needs to compensate those who supplied him.

The issue of debt comes in if a downstream customer is unable to pay an upstream supplier in time while the upstream one has to pay his suppliers. The upstream customer might have to resort to borrowing to ensure he has the cash flow to tide over the time while he is expecting payments from downstream. This should be a simple matter as long as the downstream customer does pay. If the payment is too delayed and the upstream supplier has to bear a large cost of interest on arranging for an alternative financial source, or if the payment does not come through or has a probability of not coming through, we have a bigger problem.

Here, the problem of circular debt can emerge when one of the producers in the value chain starts borrowing to pay others on the basis of receivables and then uses these receivables as a basis of further debt or borrows from those very people who he is supposed to pay in a subsequent period. The debt cycle will become circular, and vicious, as interest payments will keep accruing on the producer who is not able to make payments in time. This is the situation our energy sector is in.

Simplifying the matter a little, the distribution companies (DISCOs) have to pay for electricity to the generation companies, who in turn have to pay their oil and input suppliers. But the payments that the DISCOs receive, from users of electricity, come in with delays, might not be enough, and so they have to resort to borrowing to pay generators. And as mentioned, due to interest payments as well as other shortfalls the debt continues to rise to the point that it becomes unsustainable and then we get the crisis and generators refuse to produce till they are given arrears. The government steps in with some cash injection, the constraints are relaxed and the cycle starts again.

But the ultimate outcome does not change. It is a matter of time before we are in the same non-sustainable situation again.

How do we resolve the issue? It seems fairly simple. We have to pay for existing debt and have to make sure that the DISCOs are getting enough to pay for the electricity they buy in a timely fashion. Simple enough.

But if the issue is this simple, why has it become so convoluted?

Initially, the problem was that though we had done contracts on electricity generation side on commercial basis, with the IPPs in particular, on the consumer side, we were not allowing the prices to go up and reflect the cost of production. This is a frequent and common mistake when products are unbundled and markets are deregulated and/or privatized. But the price hikes of the last few years seem to have taken care of that. We are charging enough now.

Now it seems it is more a problem of electricity consumers either not paying at all or not paying on time. This includes private consumers as well, though the total amount lost due to private, especially small, consumers not paying at all or not paying on time does not seem to be huge. It is more the government departments and public sector bodies and entities that seem to be more of an issue. There seem to be significant lags in payments from larger departments.

Again there are two issues here. Either these departments just do not have the budget to afford electricity. If this is the case there is no shortcut to this than giving them the additional budget that they need. Or, it is the case that the departments have enough money but they just do not prioritise the payment to their DISCOs enough.

In this case, it is a matter for the government to be strict with these entities to ensure timely payment, or for the DISCOs to have the ability to disconnect delinquent customers, or if neither of the above can be done, for the government to step in and cover the non-payment by these entities.

If the government cannot make public sector entities pay their bills on time, and if the DISCOs cannot disconnect those who do not pay or do not pay on time, or fine those who do not pay on time, how can the problem of circular debt be addressed unless there is an injection of money from somewhere. And where can this money come from except from the government? Why would anyone else want to get involved in this problem?

The government can separate out the issue of 'stock' problem—accumulated debt—and 'flow' issue—shortfall being faced period to period. For the stock issue there is little that can be done except maybe for the government to just pay it off and cut the amount from any delinquent public sector entities that have not paid in the past to recover whatever can be recovered.

On the flow issue, the government has to give the power to the DISCOs to deal with non-payments or late-payments as they should be. If an ordinary citizen does not pay the DISCOs she is taken to the cleaners and back. Why should the case be any different for public sector entities? Imagine the audacity of these organizations: they take money from the citizens as taxes and then do not spend the money where it should be spent and in the process cause further hardship to citizens in terms of higher load-shedding. Talk about being irresponsible. If this power is not allowed to the DISCOs and the culture of paying regularly and timely is not imposed on public sector entities, and those who do not pay, private or public, are not taken to task the problem of circular debt will continue. And it will get worse.

It is good that gas and other utilities do not have the type of supply chains that electricity has or we could have the same kind of issues there too.

Having said that, conceptually, the problem of circular debt is easy to resolve: charge the right price that covers the cost of production to the consumer and make the consumer—public or private—pay for electricity on time. And, set the right

efficiency incentives for the DISCOs so that they do not hide their inefficiency cost under the circular debt issue. But if the government is not willing to do that, we will continue to have circular debt issues and the government will need to continue to dole out money. The issue could not be simpler.

Source: Bari, Faisal, 'Viscious Cycle of Debt', *The News on Sunday*, Karachi, 8 April 2012.

II. Shahid Kardar explains the mechanism of the Circular Debt.

'Circular debt' in the power sector is widely understood as an issue whose solution has eluded policymakers over the last three years. This article attempts to explain the genesis of the problem and ways to resolve it.

Simply put, circular debt arises when one party, which doesn't have adequate cash flows to discharge its obligations to its suppliers, withholds payments. When it does so, the problem is transmitted to other entities in the supply chain, each of whom withholds payments, resulting in operational difficulties for all service providers in the sector. As a consequence, none are able to function at full capacity, which, in turn, gives rise to unnecessary power outages.

The circular debt numbers that get reported in the press tend to be the sum of the receivables of each organization, a practice which ends up exaggerating the amount. This is because one party's payables are the other party's receivables; logically, these should cancel out when we subtract one from the other. At the very worst, the net amount should be much smaller. In our case, however, even this net unadjusted amount is growing by Rs. 1.4 billion a day.

Let's refer to this outstanding amount as 'stock'. To be able to understand what this stock represents and its daily build-up, let's look at a simplified and abridged version of the supply chain which results in electricity being provided in our homes.

Refineries provide oil to oil marketing companies. Most of the crude oil is imported and suppliers abroad have to be paid to ensure supply and there can be no debt beyond the terms agreed for the supply of oil. These oil marketing companies sell oil to the IPPs or the WAPDA-owned electricity generation plants (gencos), which produce the electricity and sell it to the government-run distribution companies (DISCOs) such as LESCO, PESCO, etc. which provide power to our homes and factories and bill us for this service.

The tariff (price) at which the gencos sell to the discos and the tariff at which electricity is supplied to the consumers is determined by NEPRA, after governmental approval.

But the first problem arises when the tariff is unable to cover the costs of generating and distributing electricity, which results in the receivables not cancelling out payables (as argued above). For instance, if the price of oil goes up internationally and tariffs are not revised upwards to account for this increase, the government ends up picking up the difference and thereby subsidizing electricity. Currently, the cost of generation at the margin (more than Rs. 18 per unit) is almost two times the average tariff-(less than Rs. 9.50 per unit). This comparison suggests that in order to minimize this 'subsidy', the government would be better advised to have more power outages since every hour of additional generation from imported oil raises the subsidy bill by a larger margin—almost Rs. 9 per unit as against the present average of under Rs. 4 per unit.

This first component of circular debt—the provision of electricity to consumers at rates lower than the cost of generation and distribution—is also a major factor contributing to the growth in size of circular debt. By failing to foot this bill for the subsidy, the government builds-up circular debt.

But there are three other critical components, which raise costs and feed circular debt. First, there are the inefficiencies of government-owned generation and distribution companies; cozy deals struck with providers of rental power plants; overstaffing; free provision of electricity to WAPDA employees (this costs other consumers Rs. 100 million a day); poor maintenance of plant equipment; the use of obsolete technologies (which result in technical losses as well as corruption. All of these simply add—through tariff increases—to the cost of electricity consumers are constrained to bear with equanimity.

Second, there is the widespread issue of electricity theft; the cases of DISCOs in Hyderabad, Peshawar and Quetta are now well-known while no one in FATA pays for electricity.

Finally, there's the issue of poor collection of electricity bills. Federally-managed agencies and provincial governments alone owe more than Rs. 150 billion. Powerful private individuals and companies are also defaulters as are those who, in collusion with WAPDA employees, do not pay but continue to enjoy uninterrupted supply. More than Rs. 220 billion are due from private consumers although a large portion of these alleged "receivables" are dues from fictitious consumers. This category covers theft by consumers, in collusion with the staff of GENCOs, which is parked under convenient heads ranging from non-existing consumers to "unmetered connections" (a category allowed and supported by the staff at GENCOs to facilitate this corruption and which includes agricultural tube wells).

Clearly, the basic issues are failures to a) revise electricity tariffs on a timely basis; b) prevent electricity theft; and c) ensure speedy collection of billing amounts and disconnect supply to defaulters. (The disconnections will actually also reduce the extent of outages.) In other words, the principle issue is that of governance.

So what is the solution? The liabilities in the shape of the remaining inherited 'stock' of Rs. 300-odd billion can be cleared as a one-time effort even—dare I say it—through the printing of money (at the expense of a slightly higher rate of inflation). However, such a step should be made contingent on the taking of firm and clear initiatives that will prevent the build-up of circular debt again. Such a proviso is critical because the prevailing incentive structures enable those operating the sector to live with the comfortable feeling of business as usual (with the same levels of incompetence and poor governance), convinced that the government will simply step forward, yet again, a few months down the road, to bail them out.

It's fairly obvious by now that a key issue is poor governance, reflected in the government's failure to weaken the control of

powerful lobbies who continue to ride this gravy train while the rest of the population wrings its hands helplessly.

The only solution to this issue is to either immediately privatize the management or ownership of DISCOs under an appropriate regulatory framework or to hand them over to the provincial governments. The electricity can be supplied at the provincial borders for the provincial governments to purchase from the GENCOs, thereby relieving Islamabad's overstretched budget from the burden of this seemingly never-ending electricity subsidy.

The adoption of such an approach will also ensure fairness and equity: the 'line losses' (read: theft, with the collusion of staff) of DISCOs in Peshawar, Quetta, and Hyderabad will no longer have to be borne by consumers hooked to the LESCO and FESCO systems which have lower distribution losses.

Even if the provincial governments need to set up physical infrastructure such as grid stations to reduce the distribution losses stemming from technical reasons, this one-time investment is a price worth paying in the short term. And the federal government would do well to finance this investment on behalf of the provinces, even if the money needs to be provided upfront.

Source: Kardar, Shahid, 'Squaring the Circle', *Money Matters*, Karachi, October 2012.

Dealing with the immediate problem

The third National Energy Conference was held in Lahore in early April 2012 to take immediate measures to deal with the problem. One decision of the Conference was to distribute the load of the shortfall evenly across the four provinces, reducing the heavier burden on the Punjab. Government offices were to work five days a week, and all markets throughout the country were to close at 8 pm, except on weekends. Other measures were also announced to save electricity, such as cutting power to billboards and replacing regular bulbs with energy savers. To ensure smooth supply of power, additional gas has to be provided to power companies. The Prime Minister said that 700 MW of electricity would be saved by observing a five-day working week. Other measures taken focussed on enforcement and legal issues related to the prosecution of defaulters and electricity thieves.

Longer-term issues

The argument making most of the rounds in Pakistan for some years now, without much progress, is that Pakistan must turn to coal—both from its own large untapped reserves and from imports—to fuel power generation beyond the next decade if it is to ease the energy crisis which has had clear consequences on economic growth. Some experts believe that Pakistan has one of the biggest, barely-touched, single coal reserves on the planet—the massive Thar coalfield in the northern Sindh province with 175 billion tonnes of extremely high water-content, low-energy coal, although it is considered to be uneconomical to exploit. However, rising oil and gas prices; rising coal prices; and new technology to dry out watery, gaseous coal, or leave it in the ground but extract the gas from it instead, have resulted in some projects being initiated around the world. The Pakistan government this year declared the Thar coal fields a Special Economic Zone, with tax breaks and incentives to lure investors to develop coal gasification and mining as part of its strategy to fill the energy gulf.

Some large coal-fired power plants are under construction and more are being converted from fuel oil. Imports of low-grade coal are likely to be part of the near-term solution with the development of Thar a long-term prospect. There are also a few private, coal power plants under construction which will increase the country's need for imports and, once Karachi and Gwadar ports are expanded, larger vessels can be berthed which will make importing more economical.

Other sources of untapped energy are said to be solar (2.4 mn MW estimated by the Alternative Energy Board) and wind (350,000 MW). Clearly, these very exaggerated estimates are just that, and given that the target for producing 1500 MW from wind energy by 2013 is highly ambitious given that only 6 MW is produced from wind, all these numbers are mere speculation. Besides, technology is still very costly. The cheapest form of electricity in Pakistan is hydel, the total installed capacity of which is 6500 MW currently, but some experts believe that Pakistan could produce 50,000 MW from this source. There are issues of water availability and disputes over water-sharing agreements between provinces and India. Nevertheless, the Government of Pakistan has announced that it will build 7 dams producing about 13,000 MW, but the internal politics and financial arrangements of such projects do not permit one to make projections about the completion of such projects. Other sources of importing oil and gas from Iran or Turkmenistan or India, have major diplomatic and security issues, and although the government voices its concern about energy shortfall, there is more talk than solution. The government has added 1,604 MW to the system by commissioning six new independent power producers (1,264 MW) and a nuclear power plant (340 MW). A 49.5 MW wind power plant has recently obtained financing.

Many of the solutions proposed by the government, look cosmetic and have been announced in the past as well. Nevertheless, as in the past, short-term solutions, such as pumping some money into DISCOs to address the circular debt problem to ensure supply, will be found and the problem ameliorated. While this may aggravate the already weak fiscal stance of the government, more serious initiatives will require more substantive measures. Better price incentives, more fiscal resources to invest in power sector initiatives, a more stable political environment to attract FDI, and issues of management and control at the local level, are all required to address Pakistan's energy crisis.

8.7 Summary and Further Reading

8.7.1 Summary

It would surprise most people to know that the small-scale industrial sector of Pakistan has been the backbone of the economic growth and development that has taken place, particularly in the 1980s, and it continues to remain stable, in Pakistan, despite severe crises at a time when the overall manufacturing sector and investment in it, are suffering. In the 1960s, large-scale manufacturing produced high growth rates, but after the intervention in the economy by Bhutto, the small-scale sector grew to prominence. This sector, which has been consciously ignored and neglected by government—ironically, one possible reason for its success—is a major source of employment in the urban areas of Pakistan, and provides as much as 25 per cent of Pakistan's exports. In a situation where overall trends in industry show alarmingly worsening signs, the small-scale sector continues to thrive and show dynamism. However, it must be emphasized that the fortunes of the small-scale sector are closely tied to those of the rest of the economy: if growth falters, as has been the trend in recent years, so too must the small-scale sectors. However, it is very probable that rising remittances into Pakistan, a phenomenon from 2009, might spur up the small-scale sector as well.

The crisis affecting the textile industry has resulted from political interference, poor policies, bad management, and the inability of the industry to adapt to changing world demands and needs. Today, much of the industry is considered 'sick', and thousands of industrial units remain closed. The severe energy crisis since 2009, has made matters far worse.

This chapter, using numerous sources, has tried to show that the public sector has not been a complete failure, as is conventionally believed, and that public sector enterprises have been efficient, productive, and even profitable. The public sector has been much maligned, as is the trend these days, and so there have been growing moves to privatize all things owned by the state. However, privatization is no panacea, as changing ownership need not automatically result in efficiency, or any of the other attributes assumed to be inherent to the private sector. Moreover, the privatization process in Pakistan has been seen as a means to offer political patronage, and for this reason may prove to be counterproductive.

There is a consensus amongst economists in Pakistan that Pakistan's industry has been inefficient, due to high protection and warped incentives. This myth is repeated *ad nauseam* by scholars who have commented on the industrial sector. However, as we have shown, there is now growing awareness amongst a small group of academics that this has not been the case. The claim that industry is inefficient has been overstated, and the evidence presented is misleading, misunderstood, or distorted. Recent work shows that, while numerous problems and hindrances have hampered industrialization in Pakistan, most are of a structural nature, and the causes and claims that are popularly believed are in fact incorrect. Nevertheless, one cannot ignore the fact that between 2008–13, Pakistan's industrial production completely collapsed, with investment at its lowest levels. The government which assumes power after May 2013, will have to address this serious crisis in Pakistan's industrial sector and in its economy—See Appendix 8.4.

8.7.2 Further Reading

In addition to the texts mentioned in Chapters 6 and 7, which cover many of the general issues related to industrialization in Pakistan, including those covered in this chapter, other important and interesting books and papers include:

Nadvi, Khalid, *Employment Creation in Urban Micro-Enterprises in the Manufacturing Sector in Pakistan* (Bangkok: ILO/ARTEP, 1990) which details work on the informal/small-scale sector; Ijaz Nabi's *Entrepreneurs and Markets in Early Industrialization: A Case Study from Pakistan* (San Francisco: International Center for Economic Growth, 1988) and Weiss, Anita, *Culture, Class and Development in Pakistan: The Emergence of an Industrial Bourgeoisie in Pakistan* (Lahore: Vanguard, 1991). Ahmad, M. B. and Robert Laporte's *Public Enterprise in Pakistan: The Hidden Crisis in Economic Development* (Boulder, Colorado: Westview Press, 1989) gives a useful overview of the state-owned industries. The extensive and voluminous study undertaken by the economists at the Lahore University of Management Sciences in 2010, is essential reading for anyone interested in learning about new issues in the industrial sector in Pakistan. See Abid Burki et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1, Analysis Report to the Industrial Policy 2010* (Lahore: LUMS, 18 October 2010).

For more details on various aspects of industry, the references provided in the Notes should also be consulted. Newspapers, magazines, and various government publications that are published from time to time should also be reviewed to keep abreast of current issues. The government's Small and Medium Enterprise Development Association (SMEDA), is a good source for information and data, and also publishes reports. See also on privatization: Khan, Akhtar Hasan, *The Impact of Privatization in Pakistan* (Lahore: Ferozsons, 2012).

Appendix 8.1

The History of the Emergence of the Small-Scale Engineering Sector in the Punjab

The small-scale sector, particularly in the Punjab, has changed the face of industry in the province. Khalid Aftab and Eric Rahim tell us how it emerged.

At the time of its establishment in 1947, Pakistan inherited one large engineering enterprise (BECO) under a management with considerable experience in metal working. Besides this enterprise, there were less than ten medium-sized metal working and iron founding units (each employing about 20 workers) in Lahore, Sialkot, Gujranwala, and Wazirabad. In addition, these towns were also centres of considerable small-scale activity in metal working. During the Second World War, Sialkot achieved renown as a centre of manufacture of high quality surgical instruments which were exported to various parts of the Empire. Much of this production of surgical instruments was carried out small scale with fairly extensive subcontracting arrangements. (Sialkot was also famous for sports goods manufacture, again with a substantial small-scale sector.) Wazirabad, a centre of medium and small-scale cutlery manufacture, had the reputation of being West Punjab's Sheffield. Gujranwala was also a well known centre of medium and small-scale metal manufacturing. Finally, there were numerous artisan workshops in various towns catering to the farmer's needs for traditional agricultural implements and producing simple metal products for domestic use.

The indigenous labour force in the western Punjab was augmented at the time of the partition of the subcontinent by an influx from the eastern districts of workers with metal working experience. A majority of the united Punjab's blacksmiths was Muslim. A majority of the labour force in general metal work was also Muslim. Thus, with the 1947 cross-migration of Hindus and Sikhs and Muslims the Pakistan Punjab inherited more than its share of the blacksmith population and metal working labour of the united Punjab. The newcomers together with their indigenous counterparts formed a large reservoir of labour with a metal-working tradition going back many generations. Concentrated in a small number of towns they engaged in diverse metal-working activities either as labourers or as small workshop owners.

These resources formed a modest, but not negligible, base upon which future metal working in the Punjab was to be founded.

Demand from a variety of sources created markets for diesel engines, electric motors, pipes, and water pumps. The most important of these sources was irrigation in agriculture. The severe constraint imposed by water shortage on agricultural expansion was widely noted in the early 1950s. Continuing schemes launched before the partition to extend the use of tube wells, the Agriculture Department of the Punjab government, throughout the 1950s (and the 1960s), provided installation and other facilities to farmers. Although the volume of water delivered by the increasing number of tube wells during the 1950s was small, in absolute terms this development was of considerable importance in spreading the new water technology among farmers.

During the 1950s this expansion remained modest and it was confined to rich farmers in a small number of districts in the Punjab. The really spectacular expansion in demand for tube wells started from 1959–60 when the government of Pakistan's policy towards agriculture, which had suffered neglect during the 1950s, changed radically. The new policy relaxed controls and provided significant incentives for increased production. As a result, the terms of trade between agriculture and industry were improved from the point of view of the farmers who experienced a significant increase in real income. At the same time the volume of loans available to farmers for the purchase of tube wells and other inputs (for example, chemical fertilizers) increased markedly. The farmer thus had the resources to invest in improved means of water supply. He also had a strong incentive to invest because shortage of canal water, particularly at certain critical times in the year, presented a serious obstacle to increased production. After the shift in government policy towards agriculture the farmer's rate of return on investment in a tube well was estimated by one researcher at 100 per cent. Another estimated that on a 50-acre farm in Gujranwala district the cost of a diesel engine tube well was recovered in two years, and of an electric powered water pump in less than one year. Rural electrification in certain districts of the Punjab also exerted a highly favourable influence on the extension of tube well installation. Thus, from 1959–60 there was an explosion in demand for tube wells from private agriculture [from 750 tube wells installed on average annually between 1948 and 1960, to nearly 16,000 each year between 1960 and 1970]. This is also the period when small units in large numbers began to establish themselves in the industry.

. . . The small-scale sector—small production units, artisans, and the reservoir of labour with tradition in metal working—did not initially (early and mid-1950s) have the technical and other resources to respond effectively to the challenge of the expanding tube well market. However, expanding industrial activity during the period offered this sector opportunities appropriate to its resources and skills. For instance, a variety of activities (for example, electric fan making) enabled workshop owners not only to keep their skills alive but also to upgrade them. Expanding operations of large and medium sized enterprises in metal working provided opportunities for employment and acquisition of new skills. Diffusion of skills was also assisted by a number of technical and vocational training centres set up by the central and provincial governments.

Slow-speed diesel engine and centrifugal water pump production was first established in the large-scale sector and it was only gradually that the small-scale obtained the skills, technical knowledge, and physical inputs required to effect entry to the tube well industry. Diffusion of the technology for

production of tube wells proceeded simultaneously with the increasing use of tube wells in private agriculture. . . .

The initiative in producing slow-speed diesel engines and centrifugal pumps on a regular basis was taken by BECO in 1949. It obtained designs of slow-speed diesel engines from a British firm and at the same time imported equipment for their production. In 1952, it set up a joint company with KSB-AG, a West German firm specializing in pumps and turbines. (This partnership ended in 1959 when BECO purchased KSB's share in the joint company and KSB, in collaboration with a number of leading Pakistani business houses, set up a new company in the Punjab.) In the second half of the 1950s, BECO established technical collaboration with overseas—American (turbines), British (electric motors), and German (high-speed diesel engines)—firms. Thus over the decade all or much of the technical know-how required for the production of various types of diesel engines, water pumps, etc. was imported into the Punjab through the medium of BECO.

BECO and other large and medium-sized firms were able to draw on the reservoir of labour with metal-working experience for the manpower required for their expansion. The large and, subsequently, the medium-sized enterprises (in the course of their normal production and under apprenticeship schemes they were obliged by law to operate) trained a substantial number of workers in the production of diesel engines and pumps and, in this way, knowledge of this technology was more widely disseminated. Many of the new small units that entered the industry from 1959-60 were set up by (or in collaboration with) skilled workers who had obtained the necessary experience with one of the larger firms. Many tube well components requiring advanced technology in their manufacture were initially imported, later being locally produced by the large firms. By the late 1950s small units had access to these and other inputs. Some of the medium-sized firms benefitted in a similar way from co-existence with the large firms, they also had access to labour trained, and components and equipment produced, by the large firms. In their turn, when markets began to expand rapidly in the late 1950s, the medium-size firms often found it necessary to give out part of their work to small workshops in the neighbourhood. In this way know-how was passed on to many workshops who later set up their own production.

Source: Aftab, Khalid and Eric Rahim, 'Emergence of a Small-Scale Engineering Sector', *Journal of Development Studies*, 1986, vol. 23, no. 1, 61–6.

Appendix 8.2

Helping the Small-Scale Sector: Good Intentions or Stifling Dynamism?

The Panel of Economists created by the Planning Commission of the Government of Pakistan in 2010, came up with a number of solutions in order to capture the dynamism of the small-scale sector, the emphasis of which is government intervention. However, as we have argued, the dynamism of the small-scale sector exists largely because the government does not, or cannot, interfere in how the sector functions.

Inclusive growth through small scale enterprises: the role, constraints, and institutional imperatives

Since small scale industries have higher employment elasticities, smaller Incremental Capital Output Ratios (ICORs), and shorter gestation periods, therefore, an increased share of investment in this sector could enable both a higher GDP growth for given levels of investment as well as higher employment generation for given levels of growth. At the same time if the institutional conditions could be created for enabling small scale industries to move into high value added components for both import substitution in the domestic market and for exports, Pakistan's balance of payments pressures could be eased. The key strategic issue in accelerating the growth of SSEs is to enable them to shift to the high value added, high growth end of the product market. These SSE's include high value added units in light engineering, automotive parts, moulds, dyes, machine tools, and electronics and computer software. . . .

A large number of small scale enterprises (SSEs) in the Punjab and the North Western Frontier Province (NWFP) have a considerable potential for growth and high value added production such as components for engineering goods or components of high quality farm implements for the large scale manufacturing sector. Yet they are in many cases producing low value added items like steel shutters or car exhaust pipes resulting in low profitability, low savings and slow growth.

Constraints to the rapid growth of SSEs

Small scale enterprises in small towns of Pakistan face the following major constraints:

(a) Inability of small units to get vending contracts for the manufacture of components from the large-scale manufacturing sector (LSM), (b) Due to lack of expertise in production management and the frequent inability to achieve quality control it becomes difficult to meet tight delivery schedules. (c) Lack of specific skills like advanced mill work, metal fabrication, precision welding, all of which are needed for producing quality products with low tolerances and precise dimensional control. In other cases accounting and management skills may be inadequate. (d) Difficulty faced by small units in getting good quality raw materials, which often can only be ordered in bulk (for which the small entrepreneurs do not have the working capital), and from distant large cities, (e) Lack of specialized equipment, (e) Absence of fabrication facilities such as forging, heat treatment, and surface treatment which are required for manufacture of high value added products, but are too expensive for any one small unit to set up, (f) Lack of capital for investment and absence of credit facilities.

The institutional framework for overcoming the constraints to the growth of SSEs

Overcoming the aforementioned constraints would involve providing institutional support in terms of credit, quality control management, skill training, and marketing. This could be done by facilitating the establishment of Common Facilities Centres (CFCs) located in the specified growth nodes in selected towns where the entrepreneurial and technical potential as well as markets already exist. Such support institutions (CFCs) while being facilitated by the government and autonomous organizations such as SMEDA can and should be in the private sector and market driven.

The institutional features of CFCs are identified in the ensuing section. The specific technical facilities required for the CFCs, the product groups they could serve and the geographic locations of enterprise clusters are given in the Appendix-VI of this Report.

The specific institutional features of CFCs

The concept of the Common Facilities Centers is based on the fact that small-scale industrialists in Pakistan have already demonstrated a high degree of entrepreneurship, innovation, and efficient utilization of capital. The CFCs would provide an opportunity for rapid growth to SSEs through local participation in extension services, prototype development, and diffusion of improved technologies, equipment, and management procedures.

Each of the CFCs would be designed to serve a cluster of products/process related enterprises. Each cluster of enterprises could be aggregated into a corporate entity which would jointly own the CFC, with each enterprise contributing equity to the CFC.

Each CFC would constitute a decentralized hub for the SSE cluster for ensuring continuous easy access to a comprehensive package of support services such as: (i) product development, (ii) technical services, (iii) skill training, (iv) quality control systems, (v) managerial advice, (vi) purchase of high quality raw materials, (vii) marketing, (viii) institutional link up with large scale enterprises to supply them with outsourced products and components (ix) The CFCs could also perform the role of financial intermediation with the banking system and enable individual SSEs to access credit.

The CFCs could also be linked up with national research centres, such as the PCSIR and donor agencies for drawing upon technical expertise and financial resources of these agencies in the service of small scale industrial enterprises (SSEs). In this context it is advisable to establish institutional links between the research centres within Pakistan such as the PCSIR and Pakistan's manufacturing sector in general and small industries in particular. It is important to translate science research into products, processes and technological change that is market driven and required by the small scale in the small scale sector. Of particular relevance is the need to re-orient the link between the PCSIR and industry to enable certification of products and quality standards for exportables.

Organizational features and functions of CFCs

The Common Facilities Centres could have the following functional dimensions:

(i) Marketing

Provision of orders from the large-scale manufacturing sector for components, and from farmers for farm implements. These orders would then be subcontracted to the cluster of SSI units that the CFC is supposed to serve. The individual order would be subcontracted to the SSI on the basis of the skills and potential strengths of the unit concerned.

(ii) Monitoring and Quality Control

Having given the subcontract, the CFC would then monitor the units closely and help pinpoint and overcome unit specific bottlenecks to ensure timely delivery and quality control of the manufactured products. These bottlenecks may be specialized skills, equipment, good quality raw material, or credit.

(iii) Skill Training and Product Development

Skill training for technicians could be provided by the new good quality vocational training institutes (VTIs) established by the Vocational Training Council of Punjab. Similar VTIs could be established in other provinces. The CFC would provide specialized supplementary skill training on its premises to workers in the satellite SSI units when required. At the same time, it would provide advice on jigs, fixtures, special tools, and product development where required.

(iv) Forging and Heat Treatment Facilities

The CFCs would establish at their premises plants for forging, heat treatment, and surface treatment. The SSI units could come to the CFC to get such fabrication done on the products they are manufacturing on subcontract, and pay a mutually agreed price for this job to the CFC.

(v) Credit

The CFC would provide credit to the SSEs for purchase of new equipment and raw materials. In cases where raw materials are available in bulk supply, the CFC could buy it from the source, stock it on its premises, and sell at a reasonable price to units as and when they need them.

Final Report of the Panel of Economists, *Medium Term Development Imperatives and Strategy for Pakistan*, (Islamabad: Planning Commission, Government of Pakistan, April 2010), 98–101.

Appendix 8.3

Privatization and the Energy Crisis

Kamal Munir and Salman Khalid traced the genesis of Pakistan's severe energy crisis after the mid-2000s, and particularly after 2008, in the privatization policies two decades ago.

> In recent months, the Pakistan government has come under tremendous pressure to fix the dire energy situation. Entire cities plummet into darkness for up to 12 hours a day, and industry has come to a grinding halt. The government responds with making false promises and holding "energy summits" that invariably come to nothing. The blame is always put on the people who are deemed to have gotten used to "subsidies" and the non-bill-payers. What no one seems to question is the policy shift that has led to a situation where people are deprived of energy despite excess capacity in the system, and yet this is where the problem lies. This article attempts to explain how this situation has arisen.

Private power

It was in the midst of much hype that Pakistan launched the privatization of its power sector. The initiative was based on the 1994 private power policy, whose main contours were almost entirely defined by the World Bank which had long been pushing for opening the sector to private investment through generous incentives. The policy and the deals that were struck under it were lauded universally by private financiers as well as by most development institutions. The policy was even lauded by the then United States Secretary of Energy, Hazel O'Leary, who described it as 'the best energy policy in the whole world'. O'Leary's mission to Pakistan was lauded in the US Congress in these terms: "Energy Secretary Hazel O'Leary has just returned from a highly successful mission to Pakistan, which has opened new doors to American business leaders and may represent as well an important turning point in our diplomatic relationship with Pakistan". O'Leary was accompanied by 80 American business executives, primarily from the energy sector. The O'Leary trip resulted in the signing of 16 contracts worth nearly $4 billion.

The 1994 power policy was essentially based on the structure evolved for the Hub Power Project (or HUBCO), a 1,292 MW, $1.6 billion project that was celebrated widely amongst global investors. Euro money Institutional Investor first hailed the deal as "Deal of the Year", and later as "Deal of the Decade". The acclaim that this deal received meant that Pakistan had unprecedented interest from investors and had before long contracted another 19 independent power producers (IPPs) to contribute another 3,400 MW. Pakistan was advertised by the World Bank and global investors as the gold standard for privatization of the energy sector.

The deal

The policy separated generation of electricity from its transmission and distribution. Going forward, a vast majority of the new generation capacity was to be the domain of private investors who were offered a bulk tariff of US cents 6.5/kWh for sale of electricity to the still state-owned transmission and distribution companies.

Investors were to be provided a $-based internal rate of return of 15%–18% over the 25–30 years period of the power purchase agreement (however, in HUBCO's case 18% was initially agreed) after covering for operational costs, backed by sovereign guarantees of the Government of Pakistan. The IPPs could be built using up to 80:20 debt-equity ratios, although most opted for a 75:25 debt-equity ratio.

The IPPs were to be paid every month in two parts, i e. capacity payment and energy payment. The capacity payment reimbursed the IPP for all fixed costs of the power plant including debt servicing (remember the 80:20 debt-equity ratio) and provided the investor's equity return on top. These payments were to be made irrespective of whether the IPP was asked to produce electricity or not. Second, this stipulation made sure that the off-taker Water and Power Development Authority (WAPDA)/ Pakistan Electric Power Company (PEPCO)/Karachi Electric Supply Company (KESC) became contractually liable for repaying the debt (and its interest payments) taken to finance 80% of the project cost anyway.

The energy payment reimbursed the IPP for all variable costs of production (e.g. fuel costs) regardless of the type of fuel employed and its market price. All payments were indexed (if relevant) with US$/Pakistan Rs. exchange rate and inflation (local or foreign) changes. Thus, if the fixed foreign Operational and Maintenance (O&M) cost of $1/kWh is to be paid in year 1 and $1 is equivalent to Rs. 60, then the IPP was paid Rs. 60/kWh for that fixed foreign O&M component in year 1. However, if in year 2, the rupee devalued to Rs. 80 and US inflation was 2% then the IPP was paid Rs. 81.6/kWh ($1.02 multiplied by Rs. 80).

Finally, private producers were given an exemption from corporate income tax, customs duties, sales tax, and other surcharges on imported equipment. Among other incentives was permission for power generation companies to issue corporate bonds and shares at discounted prices.

The gold rush

Not surprisingly, investors rushed to invest in Pakistan's power sector and overwhelmingly set up oil-based, inefficient, single cycle power plants. Twenty IPPs (including HUBCO) reached financial closure with a combined capacity of 4,500 MW (four projects with a combined capacity of 435 MW were later terminated) and brought in a total investment of $5.3 billion, of which 25% was financed by foreign equity. It should be noted that the total predicted shortfall for which all this private investment was being brought in was only 1,500 MW! The World Bank however claims that it had advised the Government of Pakistan to contract only 2,000 MW. In any case, WAPDA was stuck with massive overcapacity for which it was contractually obligated to pay irrespective of whether it needed those IPPs to produce electricity or not.

Many thought that it would be much cheaper to follow the traditional approach of getting soft loans as a sovereign and building the power plant with WAPDA's expertise as much of the country's power infrastructure had been built that way since 1947. However, sources close to the HUBCO deal reveal that by the mid-1980s, the World Bank had indicated that soft loans would no longer be extended and the Bank would only support

international investment in Pakistan's power sector if private investment was brought in through the IPP model.

The keenness of the Bank to usher in privatization can also be gauged by the fact that it was involved in almost 88% of the total IPP capacity contracted (3,400 MW) through equity, loans, or other guarantees.

When the lights came back on

The privatization juggernaut rolled on through the 1990s. Capacity in the system increased to first meet whatever the forecast shortfall had been (this kept moving upward), and kept increasing. It took a few years for the true extent of this policy's fallout to become apparent. When lights came back on, the power sector and everything else that depended on it lay in ruins. All the promises of great service vanished. Since 1990, tariffs in rupee terms have climbed up approximately 530% for the median domestic consumer (while doubling in dollar terms) as the energy mix of the country shifted away from much cheaper hydro to thermal (read oil) based power, exposing the average consumer to the vagaries of the international oil price fluctuations. As a result, the government and the consumers found it increasingly difficult, almost impossible, to pay for this electricity. By 2011, it became usual for large parts of the country to plunge into darkness on a daily basis—all this in the presence of substantial excess, unused capacity!

In the lead up to privatization, the World Bank had provided at least three justifications for this move from public to private provision of energy. First, it claimed that the current level of service that was being provided to consumers was below par. Line losses were high and disruptions were frequent. Second, by subsidizing power production, governments were coming under increased financial strain. Facts and figures were provided to show how current expenditure on health and education were insufficient and how privatization of the energy sector would improve the government's fiscal position and free up public funds for these important causes. Finally, it was suggested that the existing subsidies were not helping the poor in any case since most of them were not connected to the grids. Thus taking away the subsidies would actually hurt the rich more than the poor.

A decade later, none of those "savings" have been allocated to healthcare and education as promised. In fact, in those sectors too, privatization has been constantly encouraged. As a result of power shortages, industry, commerce, and agriculture have been taking serious hits with the country's growth prospects dimming significantly. At the same time, residential consumers have had to endure over 8–12 hour blackouts in major cities of the country with the situation even worse in rural Pakistan.

As for improving the government's fiscal position and easing financial strain, the power policy led to a crippling of government finances through the "circular debt"—a debt that accumulated in the system because of increasing oil prices (nearly 70% of the total capacity was now based on oil-fuelled thermal units generally of low efficiency), and the consequent inability of the government to continue compensating the IPPs for fixed and variable contracted amounts. Meanwhile, the total energy produced in the country actually decreased nearly 10% between 2007 and 2010.

When the country started out on the road to privatization, its electricity generation relied on a fuel mix heavily in favour of hydro as opposed to thermal. This has now changed dramatically over the following decade with the fuel mix changing to 30% hydro and almost 70% thermal by the end of 2010. Given that Pakistan imports all of its oil and has scarce gas reserves, that the oil prices climbed to $140/barrel in this period, and combined with the fact that the much-lauded 1994 policy did not discriminate on the fuel source being employed, the consequences for Pakistan's "fiscal position" are there for all to see.

Paying the cost

The cost of this strategic policy level folly can be understood with the following comparison. As per the National Power System Expansion Plan 2010–2030 of the National Transmission and Dispatch Company (NTDC), as of 2010, WAPDA (employing hydro production) generated electricity at Rs. 1.03/kWh (1.2 cents/kWh) while public sector thermal power plants provided the same at Rs. 8.5/kWh (10 cents/kWh). However, the IPPs (primarily thermal) provided the same at Rs. 9.58/kWh (11.2 cents/kWh). As a result, the average blended cost of generation was Rs. 6.6/kWh (7.7 cents/kWh) in 2010 which further increased to Rs. 9.81/kWh (11.5 cents/kWh) for the end consumer due to line losses and theft in the transmission and distribution systems.

Even after adjusting for debt repayment, power production through indigenous hydro resources comes out much better. The estimated cost of energy from a majority of potential new hydro projects is expected to come under 4.5 cents/kWh according to a recent NTDC report. Moreover, the country has so far completely failed to develop its coal reserves (only 30 MW comes from coal) which are estimated at 175 billion tonnes (the second largest in the world). Engro Corporation, which owns a block of coal in Thar, estimates a tariff of 10–12 cents/kWh for Thar coal-based power production based on the current policy. The world average for coal-based power production in the energy mix is 40% while it is only 0.1% in Pakistan.

Incredibly, most policymakers continue to blame non-bill-payers, line losses (which are adjusted in the cost of production!) and subsidies for this situation. The solution they propose is to switch off lights in a country which already boasts one of the lowest per capita electricity consumption in the world. Similarly, they keep increasing prices to supposedly meet the "true" cost of production, when the problem lies with the cost, not the price! Because of the 1994 and later 2002 power policy, the cost is several times higher than it would have been otherwise. By choosing to buy power at exorbitant rates from IPPs the government is burdening the people, not subsidizing them! As for foreign investment, because of this policy, for the sake of the 25% equity (say $25 million for a 100 MW plant) which the IPP investors typically bring in, the government ends up spending approximately $83 million (in equity returns and debt financing costs) more through the life of a 100 MW thermal IPP!

The blackout in Pakistan is a policy failure, a result of the disastrous privatization undertaken by the government at the behest of the World Bank. Blaming petty theft, line losses, or subsidies is only going to create a bigger hole for the government. The only way to reverse this dire situation, which is crippling industry and plunging homes into darkness, is to reverse the 1994 policy. But for that to happen someone will first need to admit failure. Unfortunately, that possibility looks remote for the time being.

Source: Munir, Kamal and Salman Khalid 'Pakistan's Power Politics', *Economic & Political Weekly*, 23 June 2012 vol xlvii no 25, 24–27.

Appendix 8.4

Pakistan's Sagging Manufacturing Sector

It was not just 2010/11 or 2011/12 which were noticeably bad for Pakistan's manufacturing industry due to the energy crisis. This article by Nasir Jamal as early as 2008, underlined the growing malaise in Pakistan's industrial sector.

Acute energy shortages, high costs of production, sluggish domestic economy, and reduction in global demand are beginning to take their toll on the manufacturing sector. The country's industrial output, says the Federal Bureau of Statistics, fell by 6.2 per cent in the first quarter (July-September) of the current fiscal year [2007/8]. The numbers released for the first quarter of the year underscore that the large-scale manufacturing had under-performed, dampening hopes of meeting the annual target of 6.1 per cent growth in the large-scale industry.

The industrial growth has been declining for three years now. It dropped to just 5.4 per cent during the previous year from under 20 per cent in 2004-05 due to capacity constraints and high cost of doing business. The FBS figures show that the production of cotton yarn declined by 0.55 per cent, cotton cloth 0.88 per cent and powerlooms by 64.42 per cent. In the electrical sector, production of refrigerators declined by 1.6 per cent, deep-freezers 29.22 per cent, air-conditioners 22.55 per cent and TV sets 10.83 per cent. Iron and steel production declined by 1.5 per cent, pig iron 11 per cent, billets 39.26 per cent and HR sheets 22 per cent. Production of vegetable ghee dropped by 12.49 per cent and cooking oil 8.55 per cent. Production of buses declined by 41.25 per cent, jeeps and cars 47.16 per cent, and motorcycles 8.49 per cent.

'The slowdown in the industrial output was inevitable because of the cut in industrial productivity due to six to eight hours' power shutdown a-day,' Abid Farooq, former chairman of the All Pakistan Textile Mills Association (APTMA), told Dawn last week.

Hours before the Sui Northern Gas Pipeline Company, the state-owned utility, had cut off supply to 70 industrial units on Lahore-Faisalabad Road owing to what its officials said the growing demand of domestic consumers, adding to their concerns about timely shipments of their export orders. 'Most units deprived of gas supply are export-oriented textile mills. Now we hear that the utility is going to suspend supply to cement and other plants also,' he said. 'This is happening when winter has just set in. You can well imagine what treatment will be meted out to the industry in the next two months when winter will be at its peak,' he said.

Exports of manufactured goods have grown marginally in dollar value to $4.98 billion during the first four months of the current year to October from $4.52 billion last year. Textile and cotton exports have grown to $3.64 billion from $3.52 billion. Exports of other manufactured goods increased to $1.34 billion from just above $1 billion. But the manufacturers and exporters warn that full impact of the energy shortages and other negative factors on the economy will be felt in the months to come. 'True, there's a marginal rise in textile exports. But look at the industry's potential. Energy problems and spiking cost of doing business are not letting us take advantage of our potential,' argued Mr Abid.

Energy shortages are affecting smaller manufacturers more than large-scale industries. 'A number of small units have closed down in recent months because they did not have and could not arrange alternative power supply due to financial costs,' a Small and Medium Enterprise Development Authority official, who asked not to be named because he wasn't authorized to speak publicly, said. He said everyone—sanitaryware producers, fan manufacturers, sports goods exporters, auto vendors, and so on, were facing serious problems due to power cuts.

'Some have shut down their manufacturing and others laid their workers off,' he said. But he did not have the exact number of workers thrown out of job because there is no state or private institution to maintain such record in the formal or informal sectors. 'If energy shortages are causing reduction in output, the security situation is scaring foreign buyers away. The buyers are reluctant to visit us due to travel advisories. Our foreign buyers feel more comfortable in visiting and dealing with Indians, Bangladeshis, and Vietnamese because of security concerns in Pakistan,' M. I. Khurram, leading knitwear exporter, contended.

On top of that, he argued, Pakistan had become unattractive for the buyers due to rising cost of business. 'Pakistan is not a preferred destination for the American or European retail chains. We get only spillover orders,' said Khurram. 'So the reduction in industrial output should not surprise anyone in the given circumstances,' he said. The productivity as well as exports of manufacturing sector would suffer in the months to come, he added. The increasing prices of electricity and gas and spiking credit cost are blamed for the escalation in the cost of doing business and making the industry unviable.

'The growth in the cost of doing business has eroded the positive impact of currency devaluation. We are losing in the global markets despite the above 21 per cent currency depreciation,' he said. Former Lahore Chamber of Commerce and Industry president Pervaiz Hanif says the persisting economic and exchange rate instability is keeping exporters from quoting prices

for six-month orders. 'It is a difficult situation. If we undercut prices offered by our regional competitor, energy problems, exchange rate volatility, escalating inflation, etc. make the entire economic situation and exports quite untenable,' he said. Mr Khurram said the economic difficulties facing the manufacturing sector were exacerbated by the slowdown in the domestic and global sectors. 'I fear massive job loss and drop in output in the next few months.' The cost of production in the industrial sector has increased mainly because of the rising utility bills and interest rates.

The escalating cost of credit has caused fresh investment in industrial manufacturing to dry up in the last two years, increasing supply side constraints. 'There has been no significant investment in the industrial sector in the last couple of years to increase productivity,' said Abid. 'People have invested only where it was necessary to keep operations going. It is not possible to set up new industry at 22 per cent interest rate,' he added.

As most medium to large scale manufacturers somehow managed to absorb the recent hike in energy price and financial charges, they are finding it difficult to cope with power and gas cuts. 'It is a double whammy for the industry: on the one hand it raises our cost of production and on the other it results in sharp decline in our revenues,' Mr Abid said. 'And this is happening for no fault of ours.' In the given situation, he said, it had become extremely difficult for entrepreneurs to service their debts. 'The government must intervene to save manufacturers from defaulting on their loans by instructing them to delay recovery of their loans till the energy crisis is taken care of and the industry is able to operate to its full capacity,' he demanded.

Source: Jamal, Nasir, *Economic and Business Weekly, Dawn*, Karachi, 24 November 2008.

Notes

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23. Sayeed, Asad, op. cit., 1995, 143.
24. Ibid. 144.
25. Nadvi, Khalid, op. cit., 1990, 182.
26. Aftab, Khalid and Eric Rahim, op. cit., 1986, 73.
27. Sayeed, Asad, op. cit., 1995, 144–5.

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29. Nadvi, Khalid, op. cit., 1990, 125.
30. Asian Development Bank, op. cit., 1985, 420.
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9 Balance of Payments and Trade Regimes

The previous three chapters on the industrialization process in Pakistan and on the issues which have subsequently emerged as a consequence show that perhaps the most critical factor to affect industrialization has been the trade regime. The import substituting industrialization of the 1950s and 1960s, the non-devaluation decision in 1948, the export-led Korean War boom, the high tariffs and protection given to domestic industry in the 1960s, the devaluation decision of the Bhutto government in 1972 with its serious repercussions for the economy, the decision by the Zia regime to delink the rupee from the dollar, and all other issues related to trade and the exchange rate have, historically, had numerous consequences for the rest of the economy, and especially for the industrialization process. The trade regime in Pakistan was held responsible for gross inefficiencies in the industrial structure towards the end of the 1960s, allegations which later helped to develop a new liberal orthodoxy with respect to trade policy. The Structural Adjustment Programmes agreed to by the Pakistan governments since 1988 include trade sector reform as a major plank in the strategy. The trade regime since then has seen drastic changes in its composition and will continue to affect the way industry develops. Moreover, given the fact that the taxes raised from imports used to constitute more than half of total government revenue, changes in the tariff structure have had a significant effect on revenue generated by the government. For all these reasons, the importance of trade policy must be realized as it plays a critical role in the nature of developments within the country. And now, with globalization an unstoppable process and with the World Trade Organization (WTO) laying down the rules for trade, this new global trade and economic order will affect all countries, including Pakistan, in fundamental ways.

This chapter examines how trade policy and the changing trade regimes over the years have influenced the course of development, particularly industrialization, in Pakistan. It will also analyse how Pakistan's trade process and pattern have evolved over the last sixty-six years, where, from producing and exporting agricultural primary commodities in 1947, Pakistan today exports mainly manufactured and semi-manufactured goods. There have been many more changes in the direction of trade, the management of the exchange rate, tariffs, etc. All these factors are discussed in the sections that follow. The first section provides information about the basic structure and nature of different aspects of Pakistan's balance of payments and trade, as has been the practice in chapters which deal with large amounts of data. Subsequent sections in this chapter then, address specific issues and debates regarding trade and its impact on the economy.

9.1 Pakistan's Foreign Trade: Basic Facts

The pattern and nature of foreign trade gives a fairly good indication of the pattern and nature of the economies that enter into trade relationships. Those countries with comparative advantage in certain products are likely to produce and export those commodities. Often, they will need to import raw materials for their exports, establishing a strong link between the two. Countries that are dependent on climatic conditions for their exportable agricultural products may have to contend with output being determined by the vagaries of the weather. Single commodity exporting countries must frequently contend with changes in world demand, which can play havoc with any long-term strategy to industrialize or develop, based on foreign exchange earnings (see Box 9.1). Over time, the pattern of trade often changes, as countries move from exporting primary products to finished manufactured goods, and their imports change from consumer goods to machinery. Pakistan's foreign trade pattern follows such a sequence and this section examines that change.

In 1948/9, 99 per cent of Pakistan's export earnings were made up of just five primary commodities: raw jute, raw cotton, raw wool, hides, and tea. Pakistan fits the classical case of an unindustrialized and undeveloped country, in the early years producing and exporting only primary products and mainly dependent on adequate climatic conditions. A change began to occur early in the pattern of exports, as Pakistan's economic policies shifted towards an emphasis on industrialization (see Chapter 6). By 1951/2, the five main primary commodities contributed 93 per cent of export earnings, which by 1958/9 had fallen to 75 per cent. Pakistan's main imports in the first decade were consumer goods, cotton textiles, and cotton yarn. In these years, the direction of trade also changed: in 1948/9 India's share in exports was close to 56 per cent, but this had fallen to only 4.1 per cent a decade later. Dependence on India for imports was also reduced in this period. The main trading partners of Pakistan in the early years, not surprisingly, were the developed countries of the West, mainly the UK, the USA, Germany, Belgium, Italy, and Japan.[1]

Box 9.1

The Objectives and Tools of Commercial Policy

Viqar Ahmed and Rashid Amjad show how commercial policy and the management of foreign trade take place:

> Foreign trade management has a special significance for policymakers in developing countries since it provides opportunities to stimulate the growth process. Even if production relations are given, foreign trade offers the policymakers choices between import and local production, and export and domestic consumption, leading to a more efficient allocation of resources. Foreign trade can also transform the existing production relations by providing opportunities to remove domestic shortages of scarce factors of production, to overcome the diseconomies of the small size of the domestic market, and to exchange goods with less growth potential (for example, raw materials) with goods having more growth potential (for example, technical know-how and equipment). Commercial policy is the art of managing the exchange of goods and services between countries.
>
> In a typical developing country, particularly in the early stages of development, the bulk of exports consists of primary commodities and export earnings due to the relative inelasticity of supply, and production levels of primary goods are not only unpredictable but also vulnerable to a number of factors. The developing country also depends upon the advanced industrial countries for most of its developmental needs (technology, capital, and producer goods) and consumption requirements. The developing countries, therefore, find their external environment difficult as their terms of trade deteriorate, their access to the markets of the advanced countries is limited by tariff and non-tariff barriers, and the trade and payments gaps widen with the passage of time.
>
> The only short-term solution available to them is to seek extensive external assistance which, in due course, creates its own complications.
>
> Within the context of the compulsions of economic development, commercial policy in developing countries may pursue the following objectives:
>
> **i)** Maintaining equilibrium in the balance of payments and balance of trade, or at least limiting the extent of disequilibrium;
> **ii)** Attaining favourable terms of trade so that, with the same quantity of exports, the country is able to import greater quantities of goods and services and thus achieve a net addition to real income;
> **iii)** Promoting exports to derive the full benefits of comparative advantages and also to finance the country's import requirements;
> **iv)** Import substitution to protect domestic production, accelerate the rate of capital formation, create employment opportunities, narrow trade and payments gaps, and seek a certain degree of national self-sufficiency;
> **v)** Ensuring adequate availability of imported goods for both development and other purposes;
> **vi)** Keeping the internal and external values of the national currency at desired levels.
>
> Governments usually have a wide range of instruments of commercial policy to achieve policy goals. The most commonly used tool is the tariff structure consisting of import and export duties. Import duties can be used to influence the relative profitability of importing various commodity groups (for example, taxing development imports at lower rates than non-development imports), and to restrict the access of certain commodities to the domestic market in order to encourage savings and investment. Export duties may be used to limit the export of commodities in short supply at home and also sometimes to fill the gap between low domestic prices and high world prices.
>
> Non-tariff measures may be divided into direct and indirect trade restrictions. Direct measures comprise embargoes on the import or export of certain commodities or quota restrictions which are often specific to certain commodities, destinations, or currencies. The imposition of exchange control and the licensing of imports and exports, common in developing countries, also constitute direct trade restrictions. Licences may be issued for the import of certain commodities without much formality and with no restrictions on quantity or source. In Pakistan this is known as the Open General License (OGL) system. But for most imports, a proper licensing system is introduced which may restrict the importer to make purchases from a specific country or currency area.
>
> Indirect trade restrictions include various incentives and disincentives designed to influence the flow of foreign trade or its composition, such as a) raising or lowering margin requirements for letters of credit to import certain commodities or categories, b) fiscal incentives for industries using domestic materials aimed at reducing the demand for imported substitutes, and c) subsidies and credit concessions or priorities of certain import-replacing goods or exportable. A special tool, often used by developing countries but regarded unfavourably by international monetary and lending institutions, is the multiple exchange rate system. This seeks to maintain a high external value of the national currency in order to export goods with greater competitive advantage in the world market while importing high-priority commodities, and to maintain a low external value to export goods with lesser advantage and to import low-priority commodities.

Source: Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 241–2.

In the Decade of Development under Ayub Khan, as industry was further established and the nature of production changed, so did that of trade. In the first decade, most of Pakistan's trade had been with the developed, industrialized countries, since they produced commodities that Pakistan needed at that time. As more and more countries began to develop and industrialize, their demands and needs for foreign goods also changed. For Pakistan this meant the diversification of both export and import markets. Pakistan began to sell its exports outside the developed countries, while the developed countries now also had a choice to buy goods from other sources.

The pattern of trade took on a different story after 1971, when Bangladesh was created, for the contribution of East Pakistan in Pakistan's trade and foreign exchange had been quite substantial (see Box 9.2). Tables 9.1 to 9.3 give the basic features of the trade regime following 1971. Table 9.1 is a summary of the balance of payments, showing the main categories of earnings and expenditure related to trade. The trade balance, which is the difference between exports and imports, has for the most part been in the negative, implying that imports have been greater than exports. The current account deficit is an important statistic composed of the balance of trade and the flow of income through invisibles, such as tourism, banking services, and insurance. In Pakistan's case, the most important contribution to the balance of payments has been workers' remittances, mainly from the Middle East. In fact, for many years Pakistan's trade and economy have been highly dependent on money from the Gulf. The rest of Table 9.1 shows the contribution of foreign investment in Pakistan, and loans and aid made by donors to the country.

Table 9.2 is a more detailed table, showing Pakistan's exports and imports from 1950 to the most recent statistics. Pakistan's trade (exports plus imports) has expanded from US$759 million in 1950/1 to $68 billion in 2011/12, an increase of about 90 times. However, this figure can be a little misleading due to inflationary trends. If we examine the constant prices for trade, the 1950/1 figure was Rs. 2.9 billion, rising to Rs. 17.11 billion in 1994/5, a rise of less than six-fold. Hence in real terms, the expansion in Pakistan's trade has been less than what current prices may suggest. One of the most interesting statistics from Table 9.2 is that for the balance of trade. Except for 1950/1 and 1972/3, the balance of trade has been negative, implying that Pakistan always imports more than it exports.

The growth rates in key balance of payments components are shown in Table 9.3. One can see a fairly haphazard pattern for exports and imports from this table. The current account deficit has shown some huge fluctuations over the

Box 9.2

East Pakistan's Contribution to Trade

In 1948/9, 99 per cent of United Pakistan's foreign trade comprised of five primary commodities: raw jute, raw cotton, raw wool, hides and skins, and tea.[1] All the raw jute and tea exported came from East Pakistan. In 1951/2, 51 per cent of United Pakistan's exports were constituted by tea and raw jute alone. In 1969/70, just raw jute and jute-related manufactured products originating from East Pakistan were providing more than 47 per cent of Pakistan's total exports.[2] In 1969/70, East Pakistan was a large market for West Pakistan, absorbing 50 per cent of the West's exports, while the East wing provided 18 per cent of (West) Pakistan's total inputs for that year.

[Table 1] shows that while East Pakistan was exporting goods worth more than West Pakistan, the western wing of the country was using these proceeds to import goods into West Pakistan, far in excess of its share in exports. As the table shows, East Pakistan usually had a surplus trade balance, while West Pakistan had a huge trade deficit in all the seven years between 1960 and 1967. Hence this evidence suggests that West Pakistan was living off the exports of East Pakistan.

[1] Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82*, Oxford University Press, Karachi, 1984, 245.

[2] Government of Pakistan, *Twenty Five Years of Statistics of Pakistan*, Islamabad, 1972, 407, 408, 442.

Table 1: Visible trade balance (merchandise) (Rs. m)

	1960/1	1961/2	1962/3	1963/4	1964/5	1965/6	1966/7
Pakistan	–1,389	–1,266	–1,572	–2,131	–2,966	–1,490	–2,186
East Pakistan	244	427	230	–224	–434	186	101
West Pakistan	–1,633	–1,693	–1,802	–1,907	–2,532	–1,676	–2,287
Exports							
East Pakistan	1,259	1,300	1,249	1,224	1,268	1,514	1,668
West Pakistan	540	543	998	1,075	1,140	1,204	1,338
Imports							
East Pakistan	1,015	873	1,019	1,448	1,702	1,328	1,567
West Pakistan	2,173	2,236	2,800	2,982	3,672	2,880	3,625

Source: Institute of Developing Economies, *The Study on Japanese Cooperation in Industrial Policy for Developing Economies: Pakistan* (Tokyo: IDE, 1994), 12.

Table 9.1
Balance of Payments, Selected Years (US$ m)

Items	1976/7	1980/1	1987/8	1994/5	2001/2	2010/11	2011/12P
Merchandise exports	1,132	2,799	4,362	7,759	9,140	25,356	18,323
Merchandise imports	–2,418	–5,563	–6,919	–10,296	–9,434	35,872	29,941
Trade balance	–1,286	–2,764	–2,557	–2,537	–294	–10,516	–11,618
Non-factor services (net)	–187	–254	–553	–613	–298	–1,940	–2,131
Investment income (net)	–169	–261	–828	–1,771	–2,319	–3,017	–2,271
Income	33	95	105	182	111	716	627
Payments	–202	–356	–933	–1,953	–2,430	3,733	2,898
Private transfers (net)	590	2,242	2,256	2,437	4,249	15,687	12,931
(Workers remittances)	(578)	(2,116)	(2,013)	(1,866)	(2,389)	11,201	9,736
Current account balance	–1,052	–1,037	–1,682	–2,484	1,338		
Private capital (net)	161	261	330	1,725	1,911		
Direct investment[a]	4	71	155	1,529	–144	338	–145
Other long-term	104	137	164	101	475		
Short-term	53	53	11	95	–652		
Public capital (net)	582	811	1,242	1,072	33		
Disbursements, long-term[b]	807	843	1,679	2,559	532	2,377	1,411
Less: repayments, long-term	–128	–270	–714	–1,455	2,911		
Other (short- and long-term)[c]	–97	238	277	–32	1,513		
Allocation of SDRs (net)	0	37	0	0	–866		
Change in reserves (– = increase)	252	–45	140	–238	–2,792		
Errors and omissions (net)	57	–25	–30	–75	928	16	–538

[a] Includes portfolio investment, except Foreign Exchange Bearer Certificates and Dollar Bearer Certificates.
[b] Includes net official transfers.
[c] Includes Foreign Exchange Bearer Certificates (introduced with effect from August 1985) and Dollar Bearer Certificates (introduced with effect from April 1991).
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).
P = Provisional

last forty years, more than doubling from the previous year in 1983/4, 1987/8, and 1992/3. These variations from one year to another need to be seen in light of the whole economy. Hence, Table 9.4 shows how some of these constituents of the balance of payments have changed with respect to GDP. Exports have shown a healthy trend as their share of the GDP has increased since 1980/1, while that of imports has fallen. The trade deficit has also been brought down to manageable levels, but workers' remittances have fallen by one-third compared to the huge contribution of 10 per cent of GDP they made in 1981/2 except following the events of 9/11, in 2002—see Chapter 18. The current account deficit is one of the more important indicators for the whole of the economy and has stayed on the high side, at a level which is considered to be unsustainable. Less than 3 per cent of GDP, implying that there is not too great a difference between imports and exports of all kinds, is considered a reasonable level for a country developing in the direction and at the rate of Pakistan.

Table 9.5 and Figure 9.1 show how drastically the composition of exports and imports have changed. Primary commodities, which were 99 per cent of exports in 1948/9, fell to 45 per cent in 1971/2, and were a mere 11 per cent in 1994/5, but have risen again in more recent years. Similarly, manufactured goods now contribute 70 per cent of exports, having fallen from as much as 79 per cent of Pakistan's exports in 2004/5. (However, these figures do not reveal a very important aspect of the nature of manufactured exports which is discussed below). Regarding imports, capital goods, such as machinery, and industrial raw materials have replaced consumer goods as the main imported item. In 2012, industrial raw materials constituted more than three-quarters of imports, and manufactured exports constituted 70 per cent, down from 79 per cent in 2004/05.

Tables 9.6, 9.7, and 9.8 show the composition of trade in somewhat greater detail, revealing the brittle nature of Pakistan's exports. Although 75 per cent of exports are supposed to be manufactured items, in 2002/3 as much as 70 per cent of Pakistan's exports (Table 9.8) were dependent on a single commodity, i.e. cotton. Raw cotton, cotton yarn, textiles, fabrics, cotton made-ups, garments, etc. have their source in cotton; in 2012, this figure had changed little. Rice, vegetables and fruit, which formed about 8.6 per cent of exports in 2011/12 are also agricultural commodities. Hence,

Table 9.2
Exports, Imports, and Trade Balance: 1950–2012 (US$ m)

Year	Current prices		
	Exports	Imports	Balance
1950/1	406	353	53
1951/2	279	445	–166
1952/3	262	307	–45
1953/4	194	249	–55
1954/5	149	237	–88
1955/6	156	203	–47
1956/7	147	319	–172
1957/8	91	276	–185
1958/9	93	215	–122
1959/60	160	379	–219
1960/1	114	457	–343
1961/2	114	470	–356
1962/3	210	588	–378
1963/4	226	626	–400
1964/5	239	772	–533
1965/6	253	605	–352
1966/7	273	762	–489
1967/8	346	699	–353
1968/9	357	640	–283
1969/70	338	690	–352
1970/1	420	757	–337
1971/2	591	638	–47
1972/3	817	797	20
1973/4	1,026	1,362	–336
1974/5	1,039	2,114	–1,075
1975/6	1,137	2,067	–930
1976/7	1,141	2,325	–1,184
1977/8	1,311	2,810	–1,499
1978/9	1,710	3,676	–1,966
1979/80	2,365	4,740	–2,375
1980/1	2,958	5,409	2,451
1981/2	2,464	5,622	3,158
1982/3	2,694	5,357	–2,663
1983/4	2,768	5,685	–2,917
1984/5	2,491	5,906	3,415
1985/6	3,070	5,634	–2,564
1986/7	3,686	5,380	–1,694
1987/8	4,455	6,391	–1,936
1988/9	4,661	7,034	–2,373
1989/90	4,954	6,935	–1,981
1990/1	6,131	7,619	–1,488
1991/2	6,904	9,252	–2,348
1992/3	6,813	9,941	–3,128
1993/4	6,803	8,564	–1,761
1994/5	8,137	10,394	–2,257
1995/6	8,707	11,805	–3,098
1996/7	8,320	11,894	–3,574
1997/8	8,628	10,118	–1,490
1998/9	7,779	9,432	–1,653
1999/2000	8,569	10,309	–1,740
2000/1	9,202	10,729	–1,527
2001/2	9,135	10,340	–1,205
2002/3	11,160	12,220	–1,060
2003/4	12,313	15,592	–3,279
2004/5	14,391	20,598	–6,207
2005/6	16,451	28,581	–12,130
2006/7	16,976	30,540	–13,564
2007/8	19,052	39,966	–20,914
2008/9	17,688	34,822	–17,134
2009/10	19,290	34,710	–15,420
2010/11	24,810	40,414	–15,604
2011/12	23,641	44,912	–21,271

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

while in 1948/9 Pakistan exported mainly unprocessed raw primary products, sixty-six years later, exports continued to be dependent on agricultural commodities and on the weather, which can have serious effects on the level of exports.

The data for imports shows that not only does Pakistan import a great deal of machinery and capital goods; it has also imported wheat and cotton, two products in which Pakistan should have achieved self-sufficiency many years ago. Almost 4 per cent of Pakistan's imports were for wheat in 1994/5 when 2.6 million tons were imported. Animal and vegetable oils and fats used for making cooking oil contributed more than 10 per cent of Pakistan's imports in 1994/5.

Table 9.9 is revealing of the direction that Pakistan's trade has taken over the last twenty or so years. While the United States is still Pakistan's main export market—a fact that also has political overtones as discussed in Chapter 25—and was Pakistan's major trading partner for many years, its share has fallen since 1973/4. China is now Pakistan's main non-oil importing trading partner, a picture which is mirrored in most countries of the world. Moreover, after 9/11, Afghanistan has now emerged as one of Pakistan's main export markets. The rise of the Middle East as a major importer of Pakistani products after 1975 and as a source

Table 9.3
Balance of Payments Growth Rates: 1970–2002 (%)

	1970s	1980s	1990s	2000s	2008/9	2009/10
Exports	13.5	8.5	5.6	9.9	–7.2	9.1
Imports	16.6	4.5	3.2	13.7	–12.9	–0.3
Trade deficit	20.5	0.9	–0.6	60.2	–16.4	–10.2
Workers' remittances		1.9	–5.3	26.8	21.1	14.0
Current account deficit		21.2	12.2	–4.6	–35.3	–57.39

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Table 9.4
Components of Balance of Payments: 1980–2012^{P} (% of GDP Average)

Year	Exports*	Imports*	Trade deficit*	Workers' remittances*	Current account deficit**
1980–1985	8.96	18.72	9.74	8.30	3.82
1985–1990	11.28	17.10	5.82	5.94	4.00
1990–1995	13.52	17.80	4.28	3.20	4.54
1995–2000	13.68	17.40	3.72	2.10	4.50
2000–2002	15.60	17.90	2.30	2.95	–
2000–2005	12.94	15.74	2.80	3.50	1.86
2005–2010	11.64	21.84	10.20	4.08	5.16
2010–2012^{P}	9.60	16.70	7.15	4.75	0.70

^{P} = Provisional
*based on the data complied by FBS
**based on the data compiled by SBP
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

for Pakistan's imports, mainly of petroleum, is also seen in the table. Kuwait, for example, provided almost 10 per cent of Pakistan's total imports in 2010/11, all of which was oil. However, Kuwait imports very little from Pakistan. The case of Saudi Arabia is more stark, where Saudi Arabia provides Pakistan oil and nothing else, and imports very little from Pakistan in exchange. This is also the case with Malaysia, where trade with Pakistan is mainly in one direction. Malaysia provides Pakistan primarily with palm oil for the manufacture of edible oil and ghee, but Pakistan exports next to nothing to Malaysia in comparison. This pattern is reversed for Hong Kong, which used to import mostly cotton yarn, while Pakistan imported very little in return. Although there has been some diversification in the direction of Pakistan's trade since the 1970s, even by 1994/5 only four countries—the USA, the UK, Germany, and Japan—constituted more than 30 per cent of Pakistan's trade. In 2010/11, this pattern had changed, and now China is Pakistan's main non-oil producing trading partner, followed by the USA, Singapore, and Germany. However, If we include oil imports as well, then Pakistan's biggest trading partner is the UAE, followed by Saudi Arabia and Kuwait. The surprise in trade direction has been the rise of Afghanistan as Pakistan's second biggest export market, after the US, even larger than the UAE.

One of the most important features of Pakistan's economy in recent years, and particularly since 2002/3, has been the contribution made by workers' remittances. Rising to 10 per cent of GDP in 1982/3, to a value of about $3 billion, they then decreased substantially, although they still contributed 3 per cent of GDP or $1.86 billion in 1994/5. The fact that Pakistan received more than $4.2 billion in 2002/3, equivalent to 15 per cent of GDP, was indeed astonishing (see Table 9.10). This issue is discussed further in Chapter 18 where we examine the very special and specific circumstances which gave rise to this phenomenal increase. The main source of these remittances, by far, has been Saudi Arabia, followed by the United Arab Emirates. Interestingly, as Table 9.11 reveals, in 1972/3 the United Kingdom was the source of more than half of Pakistan's remittances, which were then a total of only $136 million. But, what is most surprising, as much as the surge in remittances in 2002/3, is the fact that the United States replaced Saudi Arabia as the main source of workers' remittances that year. Saudi Arabia, which contributed nearly half previously, has only contributed one-seventh in this exceptional year. The reasons for this switch are also discussed in Chapter 18. After that extraordinary year, the pattern has now returned to a new normalcy, where Saudi

Table 9.5
Economic Classification of Exports and Imports (%)

Year	Imports: Capital goods	Imports: Industrial raw material for capital goods	Imports: Industrial raw material for consumer goods	Imports: Consumer goods	Exports: Primary commodities	Exports: Semi-manufactures	Exports: Manufactured goods
1971/2	42	11	24	23	45	27	28
1976/7	38	6	40	16	41	17	42
1980/1	28	8	50	15	44	11	45
1987/8	36	7	43	14	28	20	52
1994/5	34	5	47	14	11	23	66
2001/2	28	6	55	11	11	14	75
2004–2005	36	8	46	10	11	10	79
2009–2010	28	7	52	13	18	10	72
2010–2011	24	7	53	16	18	13	69
2011–2012P	23	7	56	14	18	12	70

Note: Page 166 table 9.5 source of data should be mentioned.
^{P} = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Arabia and the UAE contribute almost half of all remittances, but the UK and the US now also provide a large amount, signalling a different trend in the nature of remittances. It is probably correct to assume that in terms of the remittances, the post-9/11 circumstances might still guide this trend but, importantly, the nature of those who now remit incomes to Pakistan, may have undergone some change. From the unskilled workers who worked in the Middle East and Gulf states in the 1970s and 1980s, a large number of skilled Pakistanis now work and live abroad. It is probable that many of them are the new export labourers who contribute. While this causes a severe brain drain on Pakistan, it allows for remittances to grow and foreign exchange revenue to rise. However, there has been insufficient research which explains the rise in these remittances, especially during a period of global recession and major political upheaval all across the Middle East.

This section has shown that, although the nature of Pakistan's trade has changed considerably in a period of almost six decades, from producing and exporting primary products to exporting manufactured products, agricultural products, particularly cotton, still form the basis of those exports. However, for many years, Pakistan's main export has not been a tangible item, but the services provided by workers in the Middle East, again a source of income that fluctuates, as the two Gulf Wars showed. Moreover, if the Middle Eastern countries decide to opt for non-Pakistani workers, or those that provide different skills (since most Pakistanis in the Middle East provide unskilled or low-skilled services), this source of foreign exchange will also become somewhat unstable as it was prior to 9/11. Between 1973/4 and 1993, Pakistan's exports grew nine-fold. However, between 1973 and 1993, Malaysia's exports increased twelve-fold, and South Korea's twenty-eight times over; Singapore's exports, from a mere $1.8 billion (slightly above Pakistan's) in 1973 rose to a staggering $151 billion in 2004, to $350 billion in 2010, which was higher than its GDP of $222 billion. In contrast, Pakistan's GDP in 2011 was around $190 billion and its exports $25 billion. Pakistan's export and trade performance by its own standards may have improved, but clearly, by any comparison, Pakistan has not been able to ride the wave of dynamic export-led growth which has become a key feature of the Asian Tigers, or even of many of the other countries in the region. Some reasons for this can be found in the following sections of this chapter.

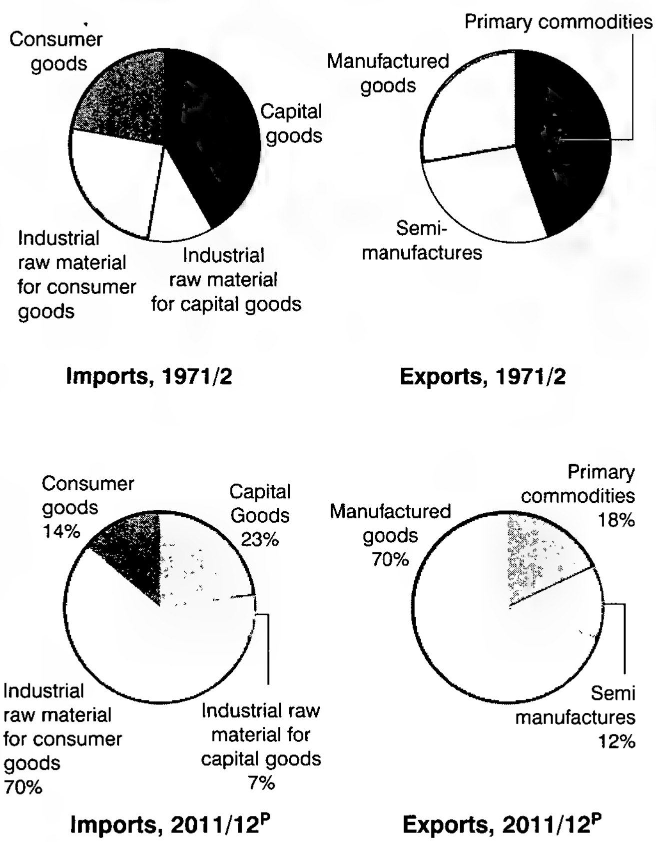


Figure 9.1
Economic Classification of Exports And Imports (%)
P = Provisional

9.2 Trade Policy and Trade Regimes

9.2.1 The Early Years: 1947–58[2]

In 1948/9, Pakistan's major trading partners were India and the UK, which together accounted for 67 per cent of Pakistan's trade, and Pakistan, along with both these countries, was a member of the sterling area. In September 1949, the pound sterling was devalued by 31 per cent, and most countries linked to sterling also devalued. Pakistan, however, decided to maintain its old exchange rate and did not devalue, making imports from the UK and India cheaper, while Pakistan's exports to these two countries became more expensive. According to Rashid Amjad and Viqar Ahmad, 'the main motivation behind the non-devaluation decision was to be able to sell raw jute to Indian industry'.[3] In 1949 more than 50 per cent of West Pakistan's trade and 80 per cent of East Pakistan's trade was with India, and raw jute and cotton accounted for about 65 per cent of exports to India.[4] India, however, was 'resentful and refused to recognize the new exchange rate of its currency in terms of the Pakistani Rupee',[5] and trade between the two countries came to a halt. The Pakistani government had to abandon its more liberal import policy and impose some 'rather loose' quantitative controls on imports and exports in September 1949.

However, the trade regime was again liberalized within one year after the Korean War broke out and demand for Pakistan's exports—which were mainly composed of jute and cotton—increased by 109 per cent. Not only was there increased demand for these raw materials, but their prices also increased appreciably. The balance of payments position improved substantially, and subsequently, trade with India was also restored, but not before Pakistan had found other trading partners as well. The Korean boom lasted about two years and, as the balance of payments situation was particularly good, the government liberalized trade to the extent that by June 1951 as much as 85 per cent of the

Table 9.6
Pakistan: Major Exports I

	1971/2		1980/1		1986/7		1994/5		2011P	
	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	US$ m	% of total	US$ m	%
Textile yarn, fabrics, made-up articles, and related products	993.0	29.45	4,170.0	14.24	26,306.3	41.52	4,295.6	52.76	3232	12.70
Articles of clothing and clothing accessories	–	–	2,715.0	9.27	9,522.7	15.03	1,669.9	20.51	2736	10.76
Leather manufacturers	–	–	–	–	–	–	–	–	1,116	4.39
Rice	274.1	8.13	5,601.6	19.13	5,139.2	8.11	454.6	5.58	2,213	8.7
Cotton	982.5	29.14	5,222.3	17.84	7,776.9	12.28	126.8	1.55	4,758	18.70
Vegetables and fruit	20.0	–	166.0	–	827.6	1.30	215.3	2.64	3,300	12.97
Fish	96.7	2.87	511.9	1.74	195.0	–	154.3	1.90	209	0.82
Others	1,005.1	29.81	10,892.8	37.20	9,433.5	14.89	943.6	11.60	873	3.43
Total	3,371.4		29,279.5		63,354.9		8,141.3		25,439	100.00

P = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Table 9.7
Pakistan: Major Imports II

	1971/2		1980/1		1986/7		1994/5		2009		2010		2011P	
	Rs. m	% of total	Rs. m	% of total	Rs. m	% of total	US$ m	% of total	US$ m	%	US$ m	%	US$ m	%
Machinery and transport equipment	1,048.6	30.00	11,590.0	21.65	27,543.5	29.80	2,989.6	28.74	5,757	18.13	5,392	17.28	5,459	15.28
Chemicals and related products	389.1	11.13	7,349.2	13.73	15,773.1	17.06	1,587.4	15.26	4,130	13.01	4,683	15.01	4,709	13.18
Petroleum and related products	294.4	8.42	15,354.0	28.68	13,976.8	15.12	1,587.5	15.26	10,763	33.90	10,998	35.24	12,941	36.22
Wheat	269.8	7.72	0.1	–	1,184.0	1.30	413.3	3.97	–	-	–	-	–	-
Animals and vegetable oil and fats	130.8	3.74	3,137.0	5.86	5,003.4	5.41	1,078.5	10.37	1,477	4.65	1,336	4.28	2,028	5.68
Cotton	9.4	–	23.0	–	–	–	307.2	2.95	646	2.03	622	1.99	1091	3.05
Others	1,353.3	38.72	16,089.8	30.05	28,950.0	31.32	2,437.6	23.43	534	1.68	20	0.06	653	1.83
Total	3,495.4		53,543.0		92,430.8		10,401.1		31,747	100.00	31,209	100.00	35,727	100.00

P = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

Table 9.8
Major Exports and Imports: 2002/3 and 2011/12

	Exports					Imports			
	US$ m		% of total			US$ m		% of total	
	2002/3	2011/12	2002/3	2011/12		2002/3	2011/12	2002/3	2011/12
Vegetable products	954.8	2,899	8.6	11.7	Animal or vegetable oils and fats	667.8	2,629	5.5	6.5
(inc. cereals)					Petroleum and related products	3,150.7	14,878	25.8	37.1
Leather related products	693.1	1,141	6.2	4.6	Chemical and related products	1,801.3	5,272	14.7	13.1
Cotton	2,351.3	4,931	21.1	20.0	Plastics and rubber	599.9	1,922	4.9	4.8
Textiles and textiles articles	5,443.2	8,250	48.8	33.5	Machinery and transport equipment	2,934.2	5,679	24.0	14.1
Others	1,717.9	7,436	15.3	30.1	Others	3,066.4	9,761	25.1	24.3
Total	11,160.3	24,657	–		Total	12,220.3	40,138	–	

Source: The State Bank of Pakistan, *Annual Report 2011–2012*, Volume I (Karachi: SBP, 2012).

Table 9.9
Pakistan: Direction of Trade (%)

Countries	1973/4		1980/1		1986/7		1994/5		2002/3		2011/12	
	Exports to	Imports from	Exports to	Imports from	Exports to	Imports from	Exports to	Imports from	Exports to	Imports from	Exports to	Imports from
USA	5.32	25.61	6.05	10.92	10.12	11.02	16.16	9.38	23.4	6.0	13.9	2.99
UK	6.76	7.05	3.97	6.12	7.14	6.68	7.06	5.11	7.1	2.9	5.2	2.26
Germany	4.56	7.79	4.3	5.03	7.03	7.52	7.01	6.77	5.2	4.6	4.7	3.44
Kuwait	1.43	3.7	–	7.99	–	7.43	–	5.81	–	6.6	0.36	9.4
UAE	1.8	–	3.5	3.6	2.8	2	3.95	1.8	9.3	12.4	7.9	16.0
Saudi Arabia	3.91	6.62	5.95	12.83	7.12	5.3	2.74	4.94	4.3	10.7	1.67	11.94
Other Middle Eastern countries	–	–	–	–	–	–	5.75	8.55	2.8	–	2.30	0.97
China	–	3.5	12.2	3.3	–	3.9	–	4.4	2.2	6.9	7.3	10.7
Hong Kong	10.98	–	3.9	–	2.8	–	6.6	–	4.6	–	–	–
Japan	6.2	9.35	6.4	11.56	10.86	16.4	6.67	9.56	1.3	6.6	2.75	3.8
Malaysia	–	–	–	2.81	–	3.02	–	8.77	–	4.6	0.63	5.4
South Korea	–	–	–	–	3.1	2.16	3.33	3.2	–	2.8	0.61	5.68
Bangladesh	–	–	2.2	1.3	1.7	–	2.08	–	1.0	–	0.1	5.66
Indonesia	9.48	–	–	–	–	–	–	–	–	2.1	3.57	0.24
Iran	3.23	1.64	7.8	–	1.5	1.08	–	–	–	2.5	0.51	0.97
India											1.3	3.12
Afghanistan											5.6	–

Source: State Bank of Pakistan, *Annual Report 2011–12*, Volume I (Karachi: SBP, 2012).

Table 9.10
Workers' Remittances: 1972–2012 (US$ m)

Year	Total
1972/3	136.00
1973/4	139.14
1974/5	211.10
1975/6	339.02
1976/7	577.72
1977/8	1,156.33
1978/9	1,397.93
1979/80	1,744.14
1980/1	2,115.88
1981/2	2,224.89
1982/3	2,885.67
1983/4	2,737.44
1984/5	2,445.92
1985/6	2,595.31
1986/7	2,278.56
1987/8	2,012.60
1988/9	1,896.99
1989/90	1,942.35
1990/1	1,848.29
1991/2	1,467.48
1992/3	1,562.24
1993/4	1,445.56
1994/5	1,866.10
1995/6	1,461.4
1996/7	1,409.5
1997/8	1,489.6
1999/00	983.73
2000/1	1,086.6
2001/2	2,389.1
2002/3	4,236.9
2003/04	3,871.6
2004/05	4,168.8
2005/06	4,600.1
2006/07	4,600.1
2007/08	6,451.2
2008/09	7,811.4
2009/10	8,905.9
2010/11	11,201.0
2011/12	13,186.6

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

imports were virtually without licence, importable on the Open General Licence System (OGL)[6] (see Box 9.1).

Following the collapse of the Korean boom, the government reimposed trade and foreign exchange controls in 1952, which according to an Asian Development Bank Study was 'probably the most important cause of the rapid rate of growth of manufacturing in Pakistan'[7] in the early years. The study continues:

> Probably the most important cause of the rapid rate of growth of manufacturing in Pakistan was the system of trade and foreign exchange controls it adopted. The country set off on this course in 1952 when it chose licensing and quantitative import controls over devaluation as a means of dealing with its balance-of-payments problems which emerged after the collapse of the Korean War raw material boom.
>
> Indeed, the import control system adopted in 1952 remained the sole basis of import licensing decisions up to 1959, and was dominant in these decisions throughout the 1960s. This system allowed the rupee to remain overvalued throughout the period, which in turn created excess demand for imports at duty-paid prices and made rationing of imports via quantitative controls necessary.[8]

This policy of 'high tariff walls and stringent quantitative controls on imports'[9] was responsible for the initiation of industrialization in general, and of the import substituting industrialization in particular, which took place in the 1950s. For Stephen Lewis, the decision by the government not to devalue in either 1949 or 1952, but instead to rely on exchange controls and quantitative restrictions to control imports, was one of the 'two major factors determining the course of industrial growth in Pakistan in the 1950s and into the early sixties'.[10] As high tariffs on consumer products raised their domestic prices, and industry became more profitable as an option than trade, it became profitable to shift into the production of these commodities domestically (see Table 9.12 for the rate of duty on imported goods). Also, there was no real export promotion policy at least until 1956, when the Export Promotion Scheme, which covered 67 primary commodities and 58 manufactured goods, was introduced, whereby exporters were entitled 'to be granted import licences for certain specific items to the extent of 25 per cent and 40 per cent on various categories of manufactured goods and 15 per cent on the export of raw materials'.[11]

The trade restrictions that were imposed determined both the extent and pattern of industrialization that was established in the 1950s and that set the trend for later developments. The trade restrictions affected industrialization in two ways:

> (i) Because of the quantitative restrictions in place, the protection to domestic producers was far greater than that implied by a comparison between domestic and duty paid prices of competitive imports, and (ii) the general scarcity created by the licensing system meant that the incentives for investment were raised across

Table 9.11
Main Sources of Workers' Remittances (% of Total)

Countries	1972/3	1977/8	1980/1	1986/7	1995/6	2002/3	2004/05	2011/12
United Kingdom	53.04	6.63	8.74	8.99	7.62	6.53	8.96	11.54
Saudi Arabia	5.79	40.14	46.52	41.50	44.12	13.86	15.10	27.96
Kuwait	5.18	4.67	6.30	9.14	4.15	5.27	5.17	4.42
Oman	8.97	5.53	4.36	5.88	5.54	2.23	2.87	2.90
UAE	3.41	26.17	14.55	14.46	17.35	19.99	17.16	21.60
USA	7.34	4.46	3.35	8.42	9.70	29.53	31.17	17.70

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

> the board rather than differentially between industries. The former points to the degree of channelling of investments that did take place and the latter [indicates] that any bias created by the differences in tariff rates across sectors was offset by the licensing system.[12]

Viqar Ahmed and Rashid Amjad argue that these

> import controls became a very powerful lever in the hands of the government to affect and influence resource allocation in the domestic economy. Firstly, the import control system after 1952 favoured mainly the establishment of consumer goods industries by restricting the import of consumer goods and hindered the establishment of capital goods and intermediate goods industries since imports were freely allowed. Secondly, the government gave import licence privileges mainly to those importers who had imported during the 1950–2 period. These importers were called 'category holders' and this policy was referred to as the 'category system'. It obviously bestowed considerable economic gain on those who were in this category as they had almost a virtual monopoly in the trade of the imported items.[13]

Their analysis of these controls is that while the system was effective following the post-Korean recession between 1952 and 1955, the control mechanisms 'not only failed to keep pace with the basic economic changes, it also became a source of corruption and bribery'.[14] It further resulted in importers making monopoly profits, especially after the category system was introduced, and they argue, 'the licence system also became a source of economic disparity between East and West Pakistan',[15] as there were many more West Pakistani importers who received import licences.

The work by Stephen Lewis on trade policy and industrialization in Pakistan is of particular interest, for he has extensively analysed the relationship between the two and the effect of the former on the latter, for the 1950s and 1960s. He writes that after 1952 the salient features of the trade policy adopted by Pakistan were: '(i) overvaluation of the rupee with respect to other countries, (ii) use of quantitative controls on imports to regulate the level and the composition of imported goods and (iii) a highly differentiated structure of tariffs on imports and export taxes on jute and cotton'.[16] The tariff structure favoured in the earlier years was of a cascading type, with lower tariffs on intermediate and capital goods than on final goods or more

Table 9.12
Rate of Duty on Imported Goods by Types of Commodity: 1955–60

Description	1955/6	1956/7	1957/8	1958/9	1959/60
Consumption goods					
Essentials	35	35	35	35	35
Semi-luxuries	54	54	54	54	54
Luxuries	99	99	99	99	99
Raw materials for consumption goods	26	26	26	26	26
Unprocessed	43	43	43	43	43
Raw materials for capital goods					
Unprocessed	23	23	23	23	23
Processed	38	38	38	38	38
Capital goods					
Consumer durables	71	71	71	71	71
Machinery and equipment	14	14	14	14	14

Source: Lewis, Stephen, *Economic Policy and Industrial Growth in Pakistan* (London: Allen & Unwin, 1969).

fully processed intermediate goods. Moreover, there was no duty levied on capital goods or on industrial raw materials.

However, Lewis makes the important point that 'while the tariff structure played some role in directing resources in Pakistan, *that role was a relatively minor one*. The principal determinant of the structure of imports and the set of domestic relative prices was the import licensing system.'[17]

Moreover, he makes the very interesting observation that, despite numerous interventions and distortions by the government in the 1950s, the structure of production would have been quite similar without them. He argues that

> the differentiated effects of the tariff structure, the system of import licences, and the overvalued currency had little influence on the structure of production that began to emerge in the mid 50s since the scarcity of all manufactured goods in Pakistan made it profitable to produce almost any kind of manufacture. The restrictive trade policy *speeded the process* of industrial growth by transferring substantial amounts of income from the agricultural sector to manufactures, but it is *unlikely if the structure of production* would *have been any different* if, say, a floating exchange rate had been adopted to deal with the exchange crisis of 1952.[18]

Hence, for Lewis, unlike other observers, the trade policies and the trade regime were not the principal cause of the pattern of industrial production adopted in the first decade, but only acted as a catalyst. For Lewis, the main cause of the structure of industrial production was the imbalance between the supply and demand for manufactured goods.

9.2.2 Trade Policy and the Decade of Development

A key feature of the high growth rates in industry in the 1960s was the trade regime adopted by the military government of Ayub Khan. Possibly the single most important component of the trade policy was the Export Bonus or Bonus Voucher Scheme (see Box 9.3). A study by the Asian Development Bank summarizes the key features of the trade regime as follows:

> The martial law government which came to power in 1958 began to dismantle the system of direct controls on imports, prices, profit margins, and investment. One important component of this program was the adoption of the Export Bonus Scheme in 1959. This scheme was essentially a floating multiple exchange rate for exports. The gradual liberalization of import controls continued with the Open General Licensing System and the Repeat and Automatic Licensing Schemes introduced in 1961, and reached a peak with the introduction of the Free List for selected raw materials in 1964 [see Table 9.12]. This liberalization process was unfortunately reversed in order to meet the foreign exchange shortages which arose after the war with India in 1965, the Government once again opting for direct controls.[19]

Stephen Lewis argues that after 1959 there were a number of changes in economic policy and a shift from direct to indirect controls on imports. In addition, a 'number of measures were taken in import licensing that made market forces more important in determining the commodity composition of imports and the distribution of ownership of import licences'.[20]

Unlike in the earlier years, during the 1960s there was a direct emphasis on the promotion of manufactured exports as special consideration was given to exporting industries through the Export Bonus Scheme, and additional licences were also made available to import raw materials and spare parts. Those industries that were export-oriented received a higher percentage of entitlement in licences.

The import liberalizing programme that started in 1959 along with the Bonus Voucher Scheme was responsible for the following:

> (i) over 1959–64 total imports increased much more rapidly than exports or GNP, and the composition of imports continued to shift towards the import of capital goods and processed intermediate goods (ii) market forces were increasingly relied upon to determine the commodity composition of imports (iii) a variety of new devices were introduced into the licensing scheme to increase the flexibility of entrance into the import trade (iv) substantial increases in the rates of duties on import goods which acted from the cost side, to reduce excess demand for imports.[21]

In addition, the Open General Licensing system was expanded to allow newcomers to enter the import trade 'particularly those from areas outside the major industrial and commercial centres. One of its principal effects was to give a wider distribution of the gains from processing an import licence',[22] with a large amount of foreign exchange allocated to the new OGL importers. Hence, the monopoly of the category holders of the 1950s was broken. In 1961 eleven commodities were on the OGL list, which was increased to fifty-one by 1964. Despite the numerous liberalizing measures taken in the early 1960s, Viqar Ahmed and Rashid Amjad argue that 'the import trade was still more or less controlled by the licence system which was strongly biased towards capital goods imports'.[23]

The Export Bonus Scheme undoubtedly had a positive effect on exports in the early 1960s. The scheme compensated for the overvalued exchange rate and increased exports, particularly of manufactured goods. The export of raw jute fell from 60 per cent of total exports in 1958/9 to 20 per cent in 1968/9, while exports of cotton and jute textiles increased from 8.3 to 35 per cent in the same period, and other exports increased from 2 to 20 per cent in the same ten years.[24] The Bonus Voucher Scheme also made the import of raw materials and machinery much easier when there was increased demand for such imports. For Asad Sayeed, the scheme 'was an ingenious incentive for both export expansion and import

Box 9.3

The Export Bonus Scheme

The Bonus Voucher or Export Bonus Scheme has been singled out as one of the most important instruments causing distortions in Pakistan's trade and industrialization process. However, a few studies have challenged that assertion and this excerpt from an Asian Development Bank Study reaches different conclusions.

> Success in maintaining the momentum of growth in manufacturing during the 1960s was largely due to the Export Bonus Scheme which allowed Pakistan to avoid to some degree the inefficiencies of prolonged import substitution.
>
> Introduced in 1959, this scheme provided exchange rates to exporters of manufactured goods more favourable than the official rate. Essentially, it allowed exporters of manufactured goods to receive a percentage of their export earnings in the form of transferable Bonus Vouchers in addition to the rupee equivalent of their export earnings converted at the official rate. These vouchers allowed the holder either: (i) to purchase an equivalent amount of foreign exchange at the official rate which can be used to import any item on the Bonus list, or (ii) to sell the voucher on an organized market. Since Bonus Vouchers were generally quoted on the stock exchange at 1.5 to 1.8 times their face value, the effective exchange rate for voucher recipients was Rs. 6.19 to Rs. 7.62 per dollar or even higher against the official rate of Rs. 4.76 per dollar. This compensated exporters of manufactured goods for the overvaluation of the rupee, allowing them to successfully compete in international markets, and helped to replace import-substitution-based growth with export expansion.
>
> There is considerable evidence of the impact of the Export Bonus Scheme on promoting manufactured exports. [Meekal] Ahmad [had] found that 'empirical investigation shows that the introduction of the Export Bonus Scheme in 1959 rotated the entire export function upwards'. Nurul Islam also found a high elasticity of export supply with respect to the export incentive schemes. However, the correlation between the ranking of manufactured exports by effective exchange rates and domestic resource cost was low and insignificant, leading to the conclusion that changes in effective exchange rates brought about by the frequent variation in bonus entitlement during the post-1965 period tended to confuse private decision-makers.
>
> The Export Bonus Scheme also functioned as a safety valve for imports of critical items by industry, thus providing some flexibility to the import licensing system. However, until the mid-1960s it was primarily used for importing luxury goods since the effective exchange rate on imports under the scheme was Rs. 11.90 per dollar or more. Because of declining foreign aid and the resulting foreign exchange shortages, a cash-cum-bonus list for most industrial raw materials was introduced in 1967 which provided an intermediate rate of Rs. 8.33 per dollar. Following this, the Export Bonus Scheme became something akin to a full fledged multiple exchange rate since it operated both on the import and export sides.

Source: Asian Development Bank, *Strategies for Economic Growth and Development: The Bank's Role in Pakistan* (Manila: Asian Development Bank, 1985), 361–2.

substitution'.[25] He quotes a study where it was shown that the Bonus Voucher Scheme accounted for 72 per cent of the effect of incentives on exports.

Although exports did increase due to the Bonus Voucher Scheme, the scheme has been criticized for giving wrong signals and causing distortions (see Box 9.3). Viqar Ahmed and Rashid Amjad criticize the scheme on the following grounds:

> The value of exports covered under the scheme did increase appreciably but the data does not tell the whole story. The rise in exports of processed goods was at the expense of the raw materials that would otherwise have been exported. Also, to the extent that the diversion of certain goods from the home to the foreign market releases domestic purchasing power to procure goods which could otherwise be exported, there is a presumed loss of earnings. Moreover, allowing for a trend factor, some rise in exports may have taken place even if this scheme had not been introduced. Finally, many exporters sold their goods in the foreign market at lower prices, sometimes even below cost, since they calculated their return in rupees in which terms the loss could be made up by the sale of bonus vouchers.[26]

The early import liberalizing policy of the military government included the dismantling of the import controls of the 1950s, and the items importable on licences, which were 90.3 per cent of imports in 1960/1, fell to 39.5 per cent in 1964/5 (Table 9.13). Also, the Free List, where commodities could be imported without licences, was increased from four to fifty items in two years, and by 1964/5 about half of all imports were on the Free List.

One reason why the government was able to be so generous in its import policy was the large amount of foreign aid the military government received. More than 40 per cent of the imports of the government were financed by the foreign aid component, which was 6 per cent of GDP in 1964/5.[27] The Asian Development Bank study argues that 'clearly, the import liberalization that took place during the first half of the 1960s, would have been impossible without this large increase in aid'.[28] Following the foreign exchange squeeze when aid was severely curtailed after June 1965, the government had to abandon its liberal import policy and

Table 9.13
Change in Import Patterns from Licences to Bonus Vouchers in the 1960s

Year	Licensed	Free List[a]	Bonus
1960/1	90.3	–	9.7
1961/2	89.6	–	9.4
1962/3	86.3	2.8	10.9
1963/4	75.3	14.9	9.8
1964/5	39.5	48.9	11.6
1965/6	32.6	40.0	27.4
1966/7	26.2	49.9	23.9

[a]After June 1965, the Free List was subject to varying and increasing degrees of administrative restriction.
Source: Amjad, Rashid, *Private Industrial Investment in Pakistan, 1960–1970* (Cambridge: Cambridge University Press, 1982), 40.

felt it necessary to reimpose a number of import controls. The Free List, for example—'the most important step in the decontrol of imports taken during the first half of the 60s—was subject to increasing administrative restrictions which negated its very purpose'.[29] The Free List was reduced from sixty-six items in 1964 to fourteen in 1968 and to eleven in 1971. There was also a cut in the licensable list, but the Bonus List expanded from 215 in 1966/7 to 277 in 1970.[30]

9.2.3 A New Country: 1972–77

The Bhutto government took over a Pakistan in 1971 that was different in almost every respect from that of the 1950s and 1960s. Most importantly, the East Wing had become independent Bangladesh. Not only was half the country no longer part of Pakistan, but most of the policies of the 1960s which were held responsible for the negative outcomes regarding income and regional inequality were also quickly done away with. The People's Party government in December 1971 took over a new country and especially with regard to the trade regime.

Almost half of West Pakistan's 'exports' went to East Pakistan in 1969/70, while 18 per cent of the western region's imports came from the east (see Box 9.2).[31] East Pakistan sold its jute, tea, and other products in international markets and earned over half of united Pakistan's exports, paying for its own imports through these export receipts. On account of East Pakistan's exports, West Pakistan was in a position to import much more than its own export earnings, since raw jute and jute textiles were Pakistan's main export earners. Thus, the loss of East Pakistan was a major structural break for Pakistan. In addition, many of the reforms that were identified with the Ayub Khan regime were perceived to be the causes of income concentration in the 1960s. In May 1972 the government took steps to abolish the import licensing system, as well as the multiple exchange rate system and the Export Bonus Scheme, and the import of all luxury items was banned. However, 'the most dramatic and perhaps the most crucial of the economic measures taken in the early months of the PPP government was the devaluation of the rupee. A criticism of the Ayub and Yahya regimes had been their unwillingness to devalue the rupee, despite the exchange rate's patent unrealistic and distortive effects on exports and investment decisions.'[32]

In May 1972, along with the other measures listed above, the rupee was devalued by 56 per cent from Rs. 4.74 to one US dollar to Rs. 11, and after the US dollar was devalued in February 1973, the rupee found its new exchange value of Rs. 9.90 to one US dollar, a rate that remained fixed for about eight years (see Box 9.4).

After the devaluation, there were considerable changes in import policy. Viqar Ahmed and Rashid Amjad write that

> except for a few items reserved for industrial users, all registered importers could obtain licences for any number of importable items. The import trade was thus thrown wide open and imports were again liberalized after having gone through a restrictive phase. This was

Box 9.4
A Pegged Exchange Rate

John Adams and Sabiha Iqbal explain how the crawling peg works:

> When a country decides to peg its currency to that of a major trading partner, the rate between the two is stabilized, but the two currencies then move jointly against others. Such a policy means that the pegged country abandons autonomous control of its exchange rate which then moves independently of its policies and conditions. An increase in the value of the currency, due to a rise in the value of the currency to which it is pegged, could damage exports by limiting growth and diversification of exports. Pakistan was in this situation during the 1970s when the rupee was pegged to the US dollar. The dollar and the rupee moved downwards between 1972 and 1975 and this encouraged Pakistan's exports, but with the appreciation of the dollar in 1976–77 there were complaints from exporters that their competitiveness was being damaged. In any case, neither the downward nor the upward movement in the value of the dollar, and of the linked rupee, reflected cost and price changes in Pakistan. Moreover, Pakistan's trade has become diversified enough to reduce the predominant importance of the US dollar in its external transactions.

Source: Adams, John and Sabiha Iqbal, *Exports, Politics and Economic Development in Pakistan* (Lahore: Vanguard, 1987), 59–60.

> done in order to increase the availability of all types of goods so that industries could improve their capacity utilization and increase production in anticipation of a higher demand for exportable goods as a result of devaluation. The liberalization trend continued during the seventies and the Free List was extended to 407 items in 1976 and 438 in 1978–9.[33]

John Adams and Sabiha Iqbal write that 'a prominent feature of the Bhutto era was the absence of an explicit export policy. Between 1972 and 1977, and even beyond, Pakistan lacked a formal, organized export policy in which clear objectives and the means to realize them were laid out. . . . The government never issued a formal document, or sequence of documents, articulating an export policy.'[34] They argue that 'there was a lack of appreciation of the role of exports in the nation's development. Decisions that were made were often inconsistent with existing policy. The result was that economic incentives and disincentives for exports coexisted simultaneously.'[35]

Thus, the devaluation was seen as the main, if not the only, means of encouraging exports, and exports did indeed grow by 38.4 and 24.7 per cent in 1972/3 and 1973/4, respectively.[36] The government also collected additional revenue by imposing export taxes and was able to share in the windfall profits generated. However, the export boom was short lived due to the quadrupling of oil prices in 1974—affecting oil and fertilizer imports, and worsening the balance of payments position—and the recession that followed in the developed countries. Moreover, a sequence of bad crops due to floods, pests, and other natural factors affected cotton and rice, Pakistan's two main export items. Hence all positive effects of the devaluation were very soon lost and the consequences on the rebound were particularly severe.

The one—probably the only—positive outcome for Pakistan of the developments on the international scene in the mid-1970s was a consequence of the oil price rise and boom in the Middle East. Pakistan was one of those countries that gained in various ways from the opening up of the new markets. In terms of labour and commodity exports, the new Middle East markets were able, partially, to compensate for the loss of East Pakistan's exports. Remittances touched about US$3 billion in the 1980s and in many ways transformed the social structure of the country, but the beneficiary of the opening up of the Middle East was not Bhutto, who was responsible for building close ties with the Islamic countries, but his detractor General Zia.

It is difficult to identify many positive export-promoting measures by the Bhutto government, with the possible exception of the concessionary credit facilities for exporters, where the rate of interest charged by commercial banks on export credits was lower than the normal bank lending rate. Other than that, the following verdict from John Adams and Sahiba Iqbal best summarizes the policies of the Bhutto government towards exports.

> Between 1972 and 1977 Pakistan did not devise an adequate policy to encourage exports. The various measures were complex and provided weak incentives, often inclined towards big exporters with established records. Emerging firms did not qualify for many programs. Exemptions from excise and sales taxes were not positive incentives but merely equalized Pakistan's external competitive position. The Bhutto government was absorbed in domestic reforms and connected exports and export concessions with the previous orientation towards fostering big industries. The bureaucracy was demoralized and not charged with formulating export policy. Policy first moved in the direction of diverting potential profits from the devaluation. Poor export performance, attributable to a weak international economy and to a lack of domestic push, engendered new incentive policies. These policies were devised slowly, in a patchwork way, with many changes. The direction of movement was to facilitate most kinds of exports but most programs were not heavily utilized and were not very effective.[37]

9.2.4 The Beginning of a Liberal Trade Regime: 1977–88

Soon after coming into power, the Zia government began a series of steps to liberalize the trade regime, particularly imports, by reducing the number of banned goods and lifting other restrictions. Most non-tariff barriers, which had been imposed after the oil shock and foreign exchange stringency in the 1970s, were also removed. Between 1977 and 1983 the number of items on the Free List was increased and the procedure for importing commodities was streamlined and made much easier. In 1977, the Free List contained 438 items, and by 1982/3 91 new items had been added, including some consumer items.[38]

Despite these early measures, the World Bank, in a report examining the trade policy regime of the 1980s, argued that in 1980, 'Pakistan's import regime reached its most restrictive stage, [and] about 41% of the domestic industrial value added was protected by import bans, and another 22% by various forms of import restrictions. By 1986, the equivalent percentages were 29% and 3.7%, respectively.'[39]

The government took the step of removing explicit import quotas on non-capital imports and the 'number of commodity categories subject to import licensing value ceilings was reduced from 406 in 1980/81 to 5 consumer goods in July 1983'.[40] In addition, previously banned and restricted imports were also liberalized. In July 1983, when the import policy for the fiscal year 1983/4 was announced, the classification of imports was changed:

> Whereas previously all items not specifically permitted were banned, now all items not specifically banned were importable. Under the present system there are two lists: a banned list and a restricted list, the latter having three parts: consumer goods subject to quantitative restrictions, items importable exclusively from a tied source, and items importable by the public sector only. Along with the above changes, a

> number of items were made freely importable: 148 previously banned items, 5 items previously importable only by the public sector, and 15 items, previous importable only from tied sources. In September 1983, 70 additional items were removed from the negative list, of which 14 were transferred to the tied list, 17 were placed on the list of items importable only by the public sector, and the remaining 39 items were made fully importable. Another significant feature of import liberalization was the virtual elimination of licensing ceilings for permitted imports, though import licensing remains in effect.[41]

While tariff and import duty adjustments were a repeated occurrence in the 1980s, some measures were also taken to boost exports. These measures included export rebates, concessionary credit for exports, and income tax and import facilities for exporters. However, the most important policy reforms that affected exports were the delinking of the Pakistani rupee from the dollar and the introduction of a flexible exchange rate. Earlier, the rupee/dollar rate was fixed at Rs. 9.90 per dollar, and the strong dollar in 1980/1 also appreciated the Pakistani rupee vis-à-vis other currencies, reducing the competitiveness of Pakistan's exports on world markets.

Although there were frequent tariff reductions during the Zia regime, in 1986 Pakistan's nominal tariff rates for manufacturing industries were still among the highest in the world.[42] Table 9.14 shows the nominal tariffs faced by Pakistan's imports in 1987. In June 1987, comprehensive changes were made in the trade regime, where tariff slabs were reduced from 17 to 10. Other changes included the reduction of the economy-wide unweighted average tariff from 77 per cent to 66 per cent, while the dispersion of the tariffs remained the same. The largest proportionate decline was in capital goods, where the average tariff fell from 61 to 51 per cent.[43] Despite these changes, 'about 50% of all tariff categories, and 84% of consumer goods, carry customs duties in excess of 75%'.[44] By 1988 the World Bank felt that the trade regime that existed then 'still seems to be biased in favour of import substituting production. Domestic markets are insulated from foreign competition through non-tariff barriers and high tariffs.'[45]

9.2.5 Trade Liberalization Under Structural Adjustment: 1988 Onwards

In the budget announced in June 1988, a number of important and far-reaching measures were announced with regard to the trade policy.

> The main policy measures consisted of improving the tariff structure, reducing the number of items in the banned and restricted lists, creating a better set of export incentives, and streamlining import licensing requirements. The maximum ad valorem duty rate on all imports, with the exception for luxury cars and alcoholic beverages, was reduced from a range of 150%–225% to 125%. This change affected close to 400 items, mostly consumer goods. In conjunction with this measure, the authorities reduced the average level and narrowed the dispersion of duty rates on imported raw materials, which now range from 20 to 50% ad valorem. Greater rationalization of the tariff structure was also accomplished by consolidating the duty rates on all items with similar degree of processing within a narrow range and by adopting graduated rates on most imports according to the stage or processing. In all, tariff rates were decreased for a total of 1134 items and increased for 462 items, out of a total of more than 3200 tariff lines. The improvement in the dispersion of the duty rates, particularly for imported inputs not produced in Pakistan, should help to spur industrial activity and economic growth. Similar positive effects

Table 9.14
Unweighted Average and Frequency Distribution of Nominal Tariffs in Pakistan: 1986/7

	Manufacturing	Consumer goods	Intermediate goods	Capital goods
Average tariff (%)	67.5	100.4	57.8	51.1
Standard deviation	54.2	52.9	53.8	43.6
Frequency distribution (% of goods)				
0–25	26.5	8.6	23.9	42.3
26–50	16.0	5.5	29.2	12.4
51–75	5.3	1.8	11.6	2.5
76–100	37.2	46.8	30.3	35.9
101–125	6.2	12.5	2.9	4.3
126–150	9.0	232.6	0.8	2.5
151–175	0.1	0	0.3	0
176–200	0.2	0	0.2	0
201–350	0.5	1.2	0.3	0.1

Source: Sayeed, Asad, 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995, 126.

> should result from the decision to reduce the number of commodities whose import were previously prohibited or restricted.[46]

Under the first major Structural Adjustment Programme begun in 1988, the government of Pakistan was committed to making extensive changes in its trade regime. The major components of the agreement with the IMF which related to foreign trade were as follows:

> The emphasis is on the removal of non-tariff barriers (NTBs) and their replacement by tariffs, with the objective of reducing the number of banned commodity categories from about 400 to 80 by FY91 [1990/1], leaving only those on account of religion, security, reciprocity, and international agreements. Also on the import side, the adjustment program contains tariff measures as well, including the reduction of the maximum tariff to 125% in FY89 and further to 100% by FY91, tariff alterations aimed at establishing some escalation with the degree of processing, and gradual removal of most tariff exemptions and concessions, except the duty drawbacks afforded to exports and exemptions granted to some key industries. Phasing out tariff exemptions will help the resource mobilization effort and also constitute an important step in the process of streamlining the tariff structure. On the export side, the adjustment program continues to emphasize export promotion by replacing the previous uniform income tax rebate system with a graduated one that encourages higher valued exports, by permitting Export Houses to retain a small part (5%) of their foreign exchange earnings, and by allowing the private sector a greater involvement in exporting rice and cotton.[47]

By 1993 a number of important steps based on the Structural Adjustment Programme had been taken. The maximum tariff had been reduced from 225 per cent in 1988 to 90 per cent at the end of the adjustment programme. In March 1991, import licensing had been abolished except for commodities on the negative list, while this list of banned and restricted imports was cut down.

One of the more important policies undertaken by the government was initiated in February 1991, when resident Pakistanis were allowed to open foreign currency deposit (FCD) accounts, which were previously allowed only to foreigners and non-resident Pakistanis. The procedure for opening such FCD accounts was greatly liberalized and banks paid higher interest rates on these deposits than LIBOR.[48] Although the rupee was not fully convertible, no questions were asked about the source of funds. Foreign currency deposits increased from $1.6 billion in June 1988 to $2.3 billion in February 1991, and to $3.7 billion in June 1992, rising to more than $8.5 billion in August 1996. Of the last amount, 37 per cent was held by Pakistani residents.[49] The World Bank believed that since 1990 'the foreign exchange inflows into FCDs have significantly helped meet Pakistan's external financing requirements. In FY92 new inflows into FCDs were almost as large (about 75%) as Pakistan's total capital account balance. *However, the reliance on FCDs has increased Pakistan's vulnerability to external shocks*, in particular in view of the low reserve cover.'[50] A warning which was prescient and came true in May 1998 when the government froze the FCD accounts after its nuclear tests—see Chapter 18.

At the end of the 1988 Structural Adjustment Programme, the World Bank suggested that the government of Pakistan should take the trade policy measures further, especially with reference to the trade taxation regime. These measures included:

> (i) removal of all remaining non-tariff barriers to imports, except those in force for health, safety, and religious reasons; (ii) removal of import tax exemptions and partial concessions, except to exporters; and conversion of specific duties into ad valorem duties; (iii) reduction of the range of customs duty rates with a maximum rate of 30% and a minimum rate of 10% (with only 3 rates, 10% for raw materials, 20% for intermediates, 30% for finished consumer goods); (iv) removal of Iqra and the license fee; (v) elimination of export taxes; and (vi) extension of the coverage of the sales tax to imports of all manufactured goods, concurrently with the removal of exemptions from sales tax granted to domestically produced manufactures, and elimination of any inequality in the treatment of domestically produced and imported goods with regard to excise duties. Finally, further actions are also needed to reform the existing deletion programs (related to domestic content requirements) and to enhance the effectiveness of export promotion schemes aimed at putting exporters on a 'duty-free basis' while at the same time reviewing the cost effectiveness of other export incentives such as the income tax rebates. Such a program should be accompanied by continued active and timely use of the exchange rate policy.[51]

In light of these and other recommendations, the government in 1993 announced a new trade reform package, the main features of which were as follows:

1. Maximum tariff levels will be set at only 35 or 50 per cent with six slabs of 10, 15, 25, 35, 45, and 50 per cent. Existing tariff rates will apply to motor vehicles, alcoholic beverages, POL, wheat, fertilizers, pesticides, and life-saving drugs.
2. Tariff reduction will be phased in gradually over a three-year period.
3. Many concessions and exemptions present in the existing tariff regime will be withdrawn gradually.
4. Tariff structure will represent a cascading of nominal tariffs with progressive stages of manufacturing. Locally produced goods will be subjected to higher tariff rates compared to goods not produced domestically.

5. Tariffs on machinery and equipment will be 10 per cent unless this machinery is produced locally.
6. High-priority domestic industries (such as engineering and chemicals) will receive nominal protection of 50 per cent.
7. Raw materials and intermediate goods predominantly used in the production of exports would be subjected to zero rate of duty.
8. Existing import licence fee, Iqra surcharge, and flood relief surcharge will be merged with the statutory tariff rates.[52]

The importance of the trade regime, and imports in particular, can be gauged from the fact that 54 per cent of total federal government revenue in 1992/3 originated from import taxes. Hence, any attempt to change the tariff regime would also have significant effects on revenue generation.

Riaz Riazuddin evaluates this policy and in Table 9.15 shows the rate-wise value of imports and import duties for the fiscal year 1991/2. He shows that as much as 45 per cent of total imports were no longer subject to any duty. And although the statutory duty rates ranged from 0 to 435 per cent, 'the effective rate of duty which is the proportion of actual duty collection to the value of imports subjected to duty is only 33 per cent'.[53] The table also shows that as much as 61 per cent of collection was obtained from the statutory duty range of 40–90 per cent, while duty rates of below and above this range contributed only 16 per cent of the collection.

For Riazuddin, 'there is a likelihood that lower tariffs in the short run can cause balance of payment difficulties as well as displacement costs. The phased reduction of tariffs and gradual withdrawal of exemptions is likely to lessen these costs.'[54] These suggestions are quite different to those proposed by the World Bank, which believed that 'with regard to the phasing of the proposed reforms package, international experience *shows that a speedy process is feasible and has strong advantages*'.[55] The World Bank cites Mexico's trade reform programme of 1985–9 as a good example of this approach, where the maximum tariff rate was reduced from 100 per cent to just 20 per cent within two years. Given Mexico's geographical and political importance with respect to the USA, and the fact that it is one of the three states along with the USA and Canada which form the North American Free Trade Association (NAFTA), the comparison with Pakistan may seem a little irrelevant. Moreover, the crash of the Mexican economy in December 1994 was also blamed on the liberalization programme followed by its government, and other countries would be wiser to learn from Mexico's mistakes rather than follow its example (see also Chapter 17). (The international trade environment has changed since the formation of the World Trade Organization in 1995. Repercussions for Pakistan are discussed in Section 9.5 and Appendix 9.1.) It would be fair to say, that from the mid-1990s and after the formation of the WTO, there has not been significant reform in the trade sector in Pakistan. Most of the trade reforms were undertaken in the 1988–95 period, and other than occasional interventions to change a few rates or to give some incentives, the basic structure and direction of intervention has been the same since the mid-1990s.

9.3 The Debate Over Efficiency and the Trade Regime

Asad Sayeed writes that 'protection through tariffs, quotas and exchange rate distortions is deemed to distort allocative efficiency and hence reduce growth and productivity of the economy over time'.[56] We will now examine this claim with respect to trade policy in Pakistan, especially in the 1980s. (Although some of the discussion from Section 8.6 is repeated here, this present section focuses more on trade-related inefficiencies and the impact on the effective exchange rate.)

With respect to the rapid industrialization and high growth of exports in the 1960s, John Adams and Sabiha Iqbal summarize the issues as follows: 'Pakistan followed a highly protective industrial policy to encourage import substitution. Incentives were provided in the form of a highly graduated tariff structure, import licensing, and quantitative restrictions on imports. At the same time, elaborate stimuli were provided to encourage the export of manufactured

Table 9.15
Rate-Wise Value of Imports and Duties: 1991/2

Statutory rate of duty	Total import value	Duty-free imports	Dutiable imports	Import duty	Effective rate of duty
Zero to 40%	44,843	32,391	12,425	2,600	21
40% to 90%	67,771	20,187	47,584	19,593	41
90% to 435%	4,023	813	3,210	2,307	72
Specific	54,955	23,977	30,978	6,220	20
	171,592	77,368	94,224	30,720	33
Share in total import value	100%	45%	55%	18%	–

Note: Figures are for Custom House, Karachi, representing 85 per cent of Pakistan's total import duty collection.
Source: Central Board of Revenue, *Yearbook 1991–92* (Islamabad: CBR, 1992), 330; Riazuddin, Riaz, 'An Evaluation of Trade Policy', *Pakistan Journal of Applied Economics*, vol. X, nos. 1 and 2, 1994, 119.

goods.'[57] Asad Sayeed argues that 'the incentives provided by the tariff structure have been the central bone of contention in discussions about efficiency of the industrial sector in the 1960s'[58] And the result, for John Adams and Sabiha Iqbal as for so many others before them (see Section 8.6 in the previous chapter), was as follows:

> Although the profusion of inducements encouraged the growth of the output and exports of the manufacturing sector, they generated inefficient resource use in industry and created a bias against exports of agricultural goods. Within the manufacturing sector resources were often attracted to high-cost industries dependent upon imported inputs. Guisinger and Lewis estimated effective rates of protection for thirty industries and found negative value-added for three cases, implying that the world market value of material inputs exceeded the value of output. Others were also critical of the import-substitution policy. Pakistan's industries were using processes which were economically inefficient, when judged by world market prices for inputs and output. Since domestic prices had become distorted by tariffs, quantitative restrictions, and multiple exchange rates, economically inefficient choices of processes and techniques by private businessmen became real possibilities. In effect, producers could purchase capital inputs at well below the opportunity cost to the economy since they were direct licensees for imported goods. An incentive was thereby created to use excessively capital-intensive techniques. Khan found that the capital–labour ratio in many industries in Pakistan was higher than in countries where labour was far less abundant.[59]

We have argued in Section 8.6 that almost all these allegations were proven to be incorrect by scholars once they studied the data in much greater detail. However, even today the same sort of criticism continues to be launched of the industrial policy pursued in Pakistan.

In recent years, the World Bank and the IMF have become the greatest champions of free trade in Pakistan and all across the globe. They castigate countries like Pakistan for maintaining tariffs, restrictions, and non-tariff barriers, and, in general, an import-substituting regime. The World Bank and the IMF argue that such import-substituting policies have an anti-export bias and cause allocative inefficiencies. Their recommendations include a drastic cut in tariffs, the removal of all non-tariff barriers, and constant devaluation. They recommend a 'liberalized', 'neutral' trade regime based on the 'rationalization' of the tariff structure, with lower average tariff rates and the elimination of exemptions. For them, not to take these comprehensive steps would result in continued inefficiency.

The World Bank, in its analysis of the trade regime in Pakistan, argues that despite the very extensive and far-reaching changes that have been made since the early 1980s, 'the changes have not been substantial enough to establish a more neutral trade regime'.[60] The continued presence of non-tariff barriers is a problem because they 'generate more serious distortions, with greater resource allocation inefficiencies, than direct price protection obtained through tariffs'.[61] Moreover, they create a host of other inefficiencies, as follows:

> As is well known, import bans/restrictions break the link between domestic and international relative prices, pushing the economy further away from resource allocation patterns consistent with the country's comparative advantage. NTBs [non-tariff barriers] work to create monopolies and oligopolies through the elimination of foreign competition in industries where scale economies are important. Government attempts to regulate and control such markets rarely achieve the level of efficiency generated by the spur of foreign competition. In other industries where the domestic market is too small to support production at a minimum efficient scale, NTBs, combined with existing investment sanctioning procedures, allow several firms to operate profitably in the small domestic market with no pressure to improve their cost competitiveness. Examples of fragmentation of production are evident in some of Pakistan's manufacturing industries, such as transport equipment, polyester yarn, electrical machinery, and household appliances.[62]

The World Bank very strongly recommends the replacement of non-tariff barriers by tariffs, as the latter form of protection for domestic industry is deemed to be much less inefficient. However, due to the high tariff rates and dispersion of the tariffs, the structure is still considered to be highly inefficient and protectionist. Summarizing the main features of the trade regime in the late 1980s, with its numerous faults and resulting distortions, the World Bank argues that

> Pakistan's import regime provides high and extremely uneven levels of protection afforded to various domestic industries, with many commodities benefiting from almost absolute protection (subject to the fact that smuggling restricts these levels). Due to exemptions, baggage allowances and extensive smuggling, some products enjoy lower nominal protection than those implied by the statutory tariff rates. This combination of heavy protection and extensive exemptions and import leakages (formal and informal) has fostered an inconsistent structure of protection with indeterminate and, perhaps, continuously changing effects on the incentives for industrial investments. As a result, socially suboptimal production and investment decisions in terms of production mix, diversification and plant scale are being undertaken while other economic opportunities are foregone. Finally, as a result of the complexity and diverse effects of various elements of the protective structure, it is very difficult for the Government to determine the effects of the present import regime and thus administer the protective system in a way that supports Pakistan's economic objectives.[63]

While the foregoing quote finds faults with the trade regime on the import side, the export side is also not spared. The World Bank believes that the trade regime has a strong anti-export bias: 'The fundamental problem is that Pakistan's export growth prospects are being adversely affected by the remaining import-substituting bias of the trade regime.'[64] This anti-export bias is shown using estimates for effective exchange rates for imports and exports and their ratios (Table 9.16). The EER (effective exchange rate) ratios in the table indicates neutrality if the ratio is 1, and a bias towards import substitution and against export promotion, as is actually revealed by the table, when the ratio is greater than 1. The table shows that the import substitution bias has increased over time (row 4A), and that there is a bias against primary agricultural exports (row 4C). The final conclusion: 'both the qualitative and quantitative evidence suggests that Pakistan's trade regime is still biased in favour of import-substituting production',[65] and hence is inefficient.

Just as in the 1970s there was a strong bombardment of 'evidence' and analysis that the government in the 1960s had got its industrial and trade policies all wrong, with the result that it was claimed that there was huge inefficiency in the industrial sector, so in the 1980s and 1990s the World Bank and the IMF have taken it upon themselves to expose the persistent perceived inefficiencies in Pakistan's trade and industrial regime. However, unlike the scholars who examined Pakistan's trade and industrial structure in the 1960s and found inefficiencies, the World Bank and the IMF in the 1980s and 1990s are in a position where they cannot just recommend, but impose, alternatives. Clearly, the Structural Adjustment Programmes since 1988 are evidence of that. However, even in the 1970s and later, there were a group of scholars who showed that much of what was considered to be conventional wisdom was, in fact, pure myth, and that the extent of inefficiency in the industrial structure in the 1960s was grossly exaggerated (see section 8.6 in Chapter 8). It is possible, then, that as further independent research is conducted on the trade and industrial regime of the 1980s, much of the evidence, 'both qualitative and quantitative', will be exposed as incorrect and biased. One recent study has done just that.

The work by Asad Sayeed has shown that virtually every study and analysis conducted on the manufacturing sector in Pakistan in the 1980s argues that protection through tariffs, quotas, or exchange rate distortions affects allocative efficiency negatively and, consequently, reduces growth over time. There seems to be almost an identical repeat of the situation prevalent in the 1970s at the end of the Ayub regime, when virtually every study and analysis conducted on the manufacturing sector argued that the Ayub regime was highly inefficient. Just as the high-growth regime of Ayub Khan was labelled as inefficient, so the high-growth Zia regime been put in the same category.[66]

Asad Sayeed has taken great pains to show that much of what has been suggested about the consequences of the trade regime under Zia is incorrect. Although Pakistan had the highest average tariff rates compared with other developing countries in 1986, *there was no direct relationship with the growth performance of the manufacturing sector*—in other words, countries with low tariffs do not necessarily have high growth, and vice versa.[67] The World Bank has also held Pakistan's high tariff dispersion to be a cause of inefficiency in the industrial sector, yet it has been shown that 'a high dispersion of tariffs was central to Taiwan's successful trade regime'.[68] Moreover, it has been seen that countries with the highest dispersion in tariffs may actually have high growth rates in manufacturing.

Sayeed's study also questions the overemphasis on showing the causality between tariffs and growth, and shows that actually 'productivity growth, or any other measure of efficiency, therefore, is more critically determined by other policies and the political economy of the sector'[69] and tariffs cannot be singled out as the causal factor. The empirical and conceptual problems that effective rates of protection (a central component of perceived inefficiency in the industrial sector) had in the scholarship of researchers in the 1970s still persist, and Asad Sayeed finds that there are serious difficulties in their calculation and use. He very strongly rejects the claims made by the World Bank that Pakistan's import policy has resulted in inefficiency in industrial production. He says 'that the excessive importance given to the tariff and non-tariff barriers is unwarranted. Firstly, there is no definite conclusion that can be drawn about efficiency reducing elements from the import regime. Secondly, no major inconsistency between the tariff regime and the structure of tariff exemptions and non-tariff barriers was identified.'[70]

One of the major allegations against the Ayub regime was that, since there were inefficiencies in the nature of protection, there was too much emphasis on import substitution at the expense of exports. This was seen to be incorrect, for there was ample growth and diversification of exports under Ayub, despite inefficiencies and an anti-export bias. The same allegations that the trade regime of the 1980s was anti-export based are equally untrue, for Pakistan's aggregate export growth in this period was a healthy 9 per cent per annum. While there are numerous problems with Pakistan's export structure, especially that it has such a narrow base, that it is dependent on one commodity—cotton—and that the textile sector has been in a crisis in recent years, the annual growth of exports has, nevertheless, been quite impressive. Clearly, there is a need to diversify into more value-added products within the textile sector, and in other sectors, but it would seem to be a little harsh to draw the conclusion, as the World Bank does, that Pakistan has had an anti-export bias.

The barrage of criticism of the industrial and trade policies of the Ayub regime was never articulated into policy, for the Ayub regime was replaced by a regime which had different priorities. Moreover, those who found fault with the policies were not in a position to implement alternatives. It was another matter that much of the analysis was found to be faulty later on. The difference is that the analysis and evidence that is currently invoked to identify the extent of inefficiency in the trade regime also makes recommendations that can actually be translated into policy. It is too soon for studies to emerge, as they did earlier, to examine in detail the claims made that industry was indeed inefficient. However, even if such evidence does emerge, it may be a little late to reverse

the policies currently being advocated and implemented since they are now part of the new, pre-liberalization, globalized, conventional wisdom.

9.4 The Exchange Rate

The exchange rate has played a critical role in the trade regime and the process of industrialization in Pakistan on more than a few occasions. As early as 1949, a conscious decision by the government of the day not to revise its exchange rate downwards, i.e. devalue, in line with the devaluation of the pound sterling by about 37 per cent, caused a great deal of uproar and eventually had serious, albeit positive, repercussions for the economy of the country (see Chapter 6 and Section 9.2 above). The decision taken by the government was so important that it has become known as the 'Non-Devaluation' decision. While the young government of Pakistan faced a serious crisis on the exchange rate front so early in its tenure, which added to numerous other crises of that era, the role that the exchange rate has played throughout the nearly fifty years of Pakistan's existence is very significant indeed. This section will highlight some of the features of the foreign exchange regime in Pakistan.

Table 9.16
Effective Exchange Rates for Exports and Imports, and their Ratio

	1980/1	1984/5	1986/7[ad]
1 **Nominal exchange rate (Rs/$) – period averages**	9.90	15.15	17.00
2 **EERs for imports[a]**			
A All imports			
a) Based on statutory import levies (EERm)	19.27	30.25	33.35
b) Based on actual import taxes (EERm2)	15.74	25.90	n.a.
B Import EER by commodity categories:			
a) Consumer goods			
EERm1	25.74	40.15	40.03
EERm2	19.01	27.30	n.a.
b) Raw materials for consumer goods			
EERm1			
EERm2	15.92	30.75	n.a.
c) Raw materials for capital goods			
EERm1			
EERm2	15.25	23.76	n.a.
d) Capital goods			
EERm1	18.13	28.50	30.60
EERm2	14.81	24.09	n.a.
e) Textile products			
EERm1	24.95	38.94	38.76
EERm2	n.a.	n.a.	n.a.
3 **EERs for exports[b]**			
A All exports (EERx)	11.02	17.18	17.92
B Export EERs by commodity categories[c]			
a) Raw cotton	8.91	13.64	15.50
b) Rice	9.90	15.15	17.00
c) Cotton yarn	11.66	16.45	17.19
d) Cotton cloth	11.75	17.75	18.22
e) Leather products	10.49	16.66	18.69
f) Carpets	10.99	18.50	18.63
g) Ready-made garments	16.25	23.79	25.00
4 **EER ratios**			
A EERm1/EERx	1.75	1.76	1.86
B EERm2/EERx	1.43	1.51	n.a.
C (EERx for manufactured exports/EERx for primary agr. exports)	1.25	1.27	1.21

[a]Customs duties, sales tax, and surcharges are included in the calculations. Due to unavailability of information on domestic and international prices, no attempt was made to take scarcity premiums resulting from non-tariff barriers into account.
[b]Duty and tax drawbacks, compensatory rebates (until mid-1986), and the subsidy components of concessionary export credited and included in the calculations.
[c]Further disaggregation was not possible because of lack of detailed data.
[d]July–November period.
Source: World Bank, *Pakistan: Growth Through Adjustment*, Report No. 7118-Pak, Washington, 1988, 74.

For nearly 35 years, Pakistan maintained a fixed-peg regime for its exchange rate. The rupee was first linked to the pound sterling in the early years after 1947, and Pakistan was a member of the sterling area. Later, as the USA became more dominant across the globe, and as Pakistan's political fortunes became more aligned with those of the USA, the US dollar became the key currency with respect to the Pakistani rupee, as it did with most other currencies.

Pakistan did not devalue in 1949 when other countries linked to the pound sterling followed the fate of the pound and devalued; nor did it devalue in 1952, following the Korean War boom, once the post-boom recession had set in and foreign exchange was scarce. Instead, Pakistan pursued import controls so that imports could be regulated and the foreign exchange crisis managed. The government was criticized on both counts: for not devaluing and for imposing controls and tariffs on the free import of goods. Such controls were considered to be inefficient in attracting scarce resources, and a more market-friendly mechanism was considered to be more efficient. Finally, the first devaluation took place in June 1955, when the rupee was devalued by 30 per cent with respect to the pound sterling in order to bring it in line with other trading countries.

For the next seventeen years, the official, nominal exchange rate of the rupee was fixed at Rs. 4.76 to one US dollar. However, as far as almost all analysts are concerned, the rupee was, for most of those seventeen years, grossly overvalued (see Sections 8.6 and 9.3). Not only was the rupee overvalued, but a system of multiple exchange rates is said to have undermined all semblance of efficiency normally attributed to a reliable and correct exchange rate value. Gustav Papanek shows how the official Pakistani exchange rate was, in a real sense, a multiple exchange rate:

> Some exporters faced an effective rate of 8 rupees to the dollar, if their commodities had been assigned 40 per cent vouchers, all of which could be sold in the open market. At the other extreme, exporters who received no vouchers and export duties faced an effective rate of less than 4.7 rupees to the dollar. . . .[71]
>
> . . . The importer who could get a regular import license paid the official exchange rate (4.7 rupees to the dollar). The importer who had to buy a bonus voucher paid more than twice that amount (as much as 12 rupees to the dollar). Finally the importer who bought a voucher restricted to the import of raw materials or investment goods, could pay yet a third rate, somewhere between the other two.[72]

The entire Ayub period, despite the substantial success related to the growth rate and exports, was criticized for maintaining multiple exchange rates and an overvalued rupee. When Zulfikar Ali Bhutto took over after the elections, much of the old order was drastically changed and the rupee was devalued by 58 per cent.

Not only did the rupee find a new value of Rs. 11 to the US dollar, but the entire system of multiple exchange rates and the Bonus Voucher Scheme was done away with. Viqar Ahmed and Rashid Amjad argue that 'the substantial net devaluation of the rupee removed at one stroke the subsidy the industrialists had received in the earlier period because of the overvalued exchange rate'.[73] While earlier in 1949, 1952, and 1967 the governments had been criticized for *not* devaluing, in 1972 the government was criticized *for* devaluation and for the extent of the devaluation. The arguments which criticized the devaluation decision were as follows:

> a) devaluation on such a high scale could have been justified if domestic production of exportable goods could also be increased rapidly which was doubtful at that particular time due to the unsettled environment created by the loss of East Pakistan;
> b) devaluation increased the cost of investment [involving foreign exchange] by about 131 per cent (which was the increase in the value of the dollar in terms of the Pakistan Rupee);
> c) the internal price structure was adversely affected since devaluation raised the overall cost structure and thus accelerated the inflationary pressures on the economy.[74]

Hence, the nominal exchange rate of the Pakistani rupee was changed by the government only twice during the period 1947–82, once by 30 per cent in 1956, and then by 58 per cent in 1972. In February 1973, the US dollar was devalued by 10 per cent and hence the Pakistani rupee was revalued by 10 per cent to Rs. 9.90 per dollar, the official rate which continued until January 1982. Until then, the government had maintained a fixed-peg exchange rate, needing to intervene only twice. The rupee/dollar exchange rate was fixed, and the Pakistani rupee's fortunes were inextricably linked to those of the dollar (see Box 9.4). When the dollar appreciated, so did Pakistan's currency with respect to its numerous other trading partners. Hence, Pakistan's economy was tied to the prospects of an economy sixty times its size. While alignment in the political sphere between Pakistan and the USA had progressed a great deal, this linking of the currencies was perhaps taking things a bit too far.

On the recommendations of the IMF, the old system of pegging the rupee was replaced by a flexible exchange rate mechanism, whereby the government of Pakistan—actually the State Bank of Pakistan, to be more precise—sets a rate for the Pakistani rupee based on a weighted average of the currencies of Pakistan's major trading partners. After 1982, the US dollar no longer retained its unique status as the determinant of the rate of the Pakistani rupee, but became one of many in the basket of currencies that collectively determine that rate. This mechanism of determining the exchange rate for the Pakistani rupee vis-à-vis other currencies, established in 1982, is still followed today. However, the very controlled nature of the exchange rate market in the 1980s has given way to a more open market in the 1990s (see Box 9.5). The 'market' rate, which is indeed determined by the supply and demand for currencies, is now the official exchange rate, and the premium between official and kerb rates is rather small.

From Rs. 4.76 to one dollar in April 1972 to Rs. 9.90 for a period of nine years, once the rupee was allowed a managed float, its value depreciated by more than 230

Box 9.5

The Foreign Exchange Market

In previous years, there was no foreign exchange 'market', and the State Bank of Pakistan rationed foreign currency. All that has now changed, and foreign currency can now be purchased openly in the market.

Foreign exchange is bought and sold in Pakistan in two markets—the official market and the parallel market. In the official market, the State Bank of Pakistan (SBP) announces every morning rates at which it stands ready to buy or sell foreign currency to authorized dealers, which, in turn, transact with customers at a specified spread. Purchases and sales of foreign currency for trade transactions are required to take place through the official market. Some capital account transactions, such as repatriable foreign currency portfolio flows, also go through the official market. In addition, banks are required to turn over foreign exchange held in foreign currency accounts to SBP at the official exchange rate, and may buy the foreign currency back when the deposit matures or is withdrawn.

All other transactions take place on the parallel market, which consists of money changers licensed by the SBP. Transactions on this market are not taxed, nor are identities of the transactors recorded. The money changers set exchange rates to equilibrate market supply and demand, thereby determining the size of the premium that foreign exchange on the parallel market commands over the official rate.

The parallel foreign exchange market in Pakistan can provide potentially useful information about the likely course of future official exchange rate adjustments by the SBP. In principle, an increase in the parallel market premium should reflect market expectations that the rupee is misaligned, presumably because reserves have dwindled or because inflation has eroded external competitiveness. In either event, a devaluation would be required to ease the economy's external adjustment.

Actual daily data from the parallel market, however, suggest that, at least in recent months, the premium does not generally anticipate changes in the official rate. Indeed, the premium tends to widen immediately *after* official exchange rate adjustments by the SBP. If, following some adjustments, the official rate is held fixed for some time, the premium tends to return to its trend level. Thus, it appears that rather than responding to economic fundamentals, the parallel foreign exchange market premium responds to exchange rate moves by the SBP in the short run.

As an alternative to selling foreign exchange on the parallel market, individuals may purchase Foreign Exchange Bearer Certificates (FEBCs) from commercial banks. FEBCs, though purchased with foreign exchange, are rupee-denominated obligations of the Government of Pakistan, and pay a rupee return. The certificates, the face value of which is determined at the official spot rate when purchased, may be encashed at any time in either rupees or foreign currency. If the bearer of the FEBC chooses to encash in foreign currency, the official spot exchange rate prevailing at the time of encashment is applied. The FEBC is a bearer certificate, and the purchaser is not required to declare the source of foreign exchange at the time of purchase.

There also exists a secondary market for FEBCs, in which the certificates are bought and sold for a premium over their face value. Arbitrage between the parallel foreign exchange market and this secondary market equates the premia associated with foreign exchange and FEBCs.

Finally, there also exists a forward market for foreign exchange. Authorized commercial banks are allowed to quote forward buy and sell rates of foreign currency in rupees for transactions that would go through the official market. While these rates are set to equate supply and demand at the various maturities, they do not necessarily reflect true market forces since market players are not allowed to take positions except to offset foreign currency receipts or payments for trade transactions.

Source: ABN AMRO Economic Bulletin, *The Exchange Rate*, vol. 1, no. 7, Special Issue, Economics Department, ABN AMRO Bank N.V. [Pakistan] September/October 1995.

per cent between January 1982 and June 1996 (see Table 9.17). Figure 9.2 shows the annual depreciation for each year, ranging from a minimum of 2.3 per cent in 1994/5 to 28.28 per cent in the very first year. For much of the 1980s the fall in the value of the rupee was caused by the crawling peg or floating exchange rate, under which the State Bank of Pakistan nominally depreciated the rupee by a few paisas whenever needed. From 1993 onwards these depreciations—or technical adjustments as the State Bank called them—were supplemented by direct devaluation. However, since 2000, the State Bank has managed the rate differently through other mechanisms, rather than through direct devaluation and the rate stabilized for some years and even appreciated. However, while the exchange rate was kept steady in the 2002–08 Musharraf period, after 2008, for numerous reasons, the rupee/dollar rate saw a significant deterioration. In the 2008–13 period, the rupee depreciated by as much as 37 per cent, from Rs. 61.7 to Rs. 98.15. In the 2002–08 period the rupee/dollar rate changed only from Rs. 60.09 in 2002, to Rs. 61.76 in early 2008 when the PPP government took over—see Chapter 18 for further discussion.

How much devaluation is enough? What should be the 'correct' rate for the rupee/dollar? Many analysts feel that the Pakistani rupee has always been and continues to be overvalued, and hence Pakistan's exports are overpriced and uncompetitive compared to its competitors. They would prefer to see a substantial devaluation of the rupee at frequent intervals. Different reasons are given for this constant adjustment, some quite irresponsible (see Appendix 9.2). Nevertheless, despite the argument made repeatedly that

Table 9.17
Value and Depreciation of the Rupee since April 1972

(Part A)

	April 1972	May 1972	Feb. 1973– Jan. 1982	1982/3	1983/4	1984/5	1985/6	1986/7	1987/8	1988/9	1989/90	1990/1	1991/2	1992/3	1993/4	1994/5	1995/6
Rupees to one dollar	4.76	11.0	9.90	12.70	13.48	15.15	16.14	17.18	17.60	19.22	21.45	22.42	24.84	25.96	30.16	30.85	33.25
% change each year	–	–	–	28.28	6.10	12.39	6.50	6.40	2.40	9.20	11.60	4.50	10.80	4.50	16.20	2.30	7.80

(Part B)

	1996/7	1997/8	1998/9	1999/00	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
Rupees to one dollar	38.99	43.20	50.05	51.77	58.44	61.43	58.50	57.6	59.4	59.9	60.6	62.5	78.5	83.8	85.5	88.3
% change each year	17.26	10.79	15.86	3.43	12.88	5.11	–4.77	–1.58	3.10	0.84	1.30	3.15	25.50	6.76	2.03	3.29

Source: Government of Pakistan, Pakistan Economic Survey (Islamabad: various issues).

Pakistan's exports are inelastic (i.e. their quantity will not rise substantially even if there were some devaluation: see the first article in Appendix 9.2), the rupee has continuously lost value against foreign currencies. This may not be the best way to increase exports. Structural factors, including better-quality products, credit, and infrastructure, may be the key with which Pakistan can open the door to more and better exports. The net result of a falling rupee is likely to be highly negative.

Table 9.17 shows a continuous trend of depreciation each year since 1982/3, with the rupee losing considerable value in some years compared to the year previously. It lost 17 per cent in 1996/7 compared to the value in 1995/6 and again nearly 16 per cent in 1998/9 over the previous year. It has lost value every single year since 1982, with the exception of 2002/3 and 2003/4. In both these years, the rupee had *appreciated* in value against the US dollar bucking the earlier trend. The reasons for this are discussed in greater detail in Chapter 18 where we examine events and developments since 1998. Numerous factors and events have taken place since then which have had a bearing on Pakistan's economy in an important way, as well as on foreign exchange reserves and on the exchange rate—also see Box 9.6.

9.5 Dealing with Globalization and World Trade Organization (WTO)

9.5.1 Some Political Economy Issues

One of the most remarkable features of the last decade of the twentieth century, which will actually determine the nature of the world, its politics and most certainly its economics, well into this current century, is that of globalization. One cannot escape from this term or from its impact in even remote corners of the globe. The world has 'become smaller', 'one-world', a 'global people', and similar descriptions are defining the new world social and economic global relations. Whether it is the email, the Internet, Facebook, or information beamed through the numerous satellites on the thousands of global and regional news channels across the world, relaying live information embedded somewhere or the other, an interconnected world is a reality.

As a description, globalization refers to the widening and deepening of the international flows of trade, capital, technology, and information within a single global market. Globalization is a complex of changes produced by the dynamics of *capitalist development*—and this is important—as well as the diffusion of cultural practices associated with this development. As a prescription, those who believe that globalization will produce the best outcome for growth and human welfare, advocate the liberalization and opening up of national and global markets in the belief that the flow of trade and information will increase welfare.

In order to advance this agenda of capitalism on a global scale, or "globalization", multinational corporations have taken the lead, with multilateral organizations like the IMF, World Bank, WTO and even the UN, supporting

Box 9.6

Has Pakistan's Substantial Devaluation Increased Exports?

The general argument put forward for devaluation is that it should make our exportable commodities cheaper in the international market, in absolute terms and also compared to our competitors, and should so increase exports. The downside is that as the currency depreciates, imports also become more expensive and can cause inflation and costs to rise if a country devalues. While Tables 9.1–9.3 (in the text) show Pakistan's trade figures, Table 9.17 shows the extent of the rupee devaluation. Since 1982/3 the rupee has depreciated by nearly 500 per cent, from Rs. 9.90 to one US dollar to nearly Rs. 60 today. Clearly, exports have not risen a fraction as much.

While Pakistan's main exports have increased both in terms of volume and in terms of value, this increase has been very small compared to the fall in the value of the rupee. One reason for this is that most of Pakistan's exports are textiles and textiles still face a regime of quotas. Hence, no matter by how much the rupee depreciates compared to Pakistan's competitors in this market, Pakistan's textile exports will increase only up to the permitted quota ceiling. Hence, analysing the overall export trend in the 1990s on the basis of *volumes* exported rather than by receipts in US dollar terms, provides support to skepticism about the benefits to exports from the continual and heavy adjustments undertaken. Perhaps non-price factors, like quality, have a more important bearing on boosting factors.

There is also an interesting *moral hazard* problem involved here. The continued devaluation of the rupee may actually *retard* Pakistan's move into value-added textiles, by insulating the margins of producers of low value-added goods such as yarn and grey cloth over an extended period of time. By making windfall gains on account of a depreciating rupee, the textile industry may avoid making the required capital investment decisions to moving up the value ladder.

While exports have not grown by as much as the depreciation would have warranted, there have also been substantial import and related costs on account of this depreciation.

Having had to service a great deal of extra debt throughout the 1990s, increased devaluation raises the rupee cost for conversion of the dollar. For example, in 1995/6 external debt servicing grew by 0.5 per cent in US dollar terms, the total interest and principal payments increased by 15.5 per cent in rupee terms. In 1997/8, while debt servicing in US dollar terms was lower by over 8 per cent year on year, the rupee costs were *higher* by 17.2 per cent on account of a weaker rupee.

Two other factors associated with a cheaper rupee in the case of Pakistan, have been higher imported inflation with increases in domestic oil and petroleum, and hence, electricity prices, throughout the 1990s, and the phenomenon of 'dollarization'. Industrial electricity tariffs increased by 85 per cent in the period 1993–2000, while furnace oil's price rose by 292 per cent—both partly due to devaluation, although other factors were also responsible. *Dollarization* in Pakistan's context, seen for much of the 1990s, has been the buying of dollars in the open market *expecting* the rupee to devalue further and consistently, making profits by this conversion. With a depreciating rupee, the *expectation* that it will depreciate further, will cause it to do so as people push up the rate while buying dollars.

It seems that the costs associated with a depreciation of the rupee are *significant* while the benefits are *uncertain*.

Source: Sherani, Sakib, 'Pakistan's exchange rate management—recent experience and current policy challenges', Economics Department, ABN-AMRO Bank N.V. [Pakistan] (Islamabad, June 2000).

this agenda by preparing the ground for corporations to make headway into the expanding global market. The International Financial Institutions (IFIs) have established an institutional framework for a process of development and free international trade. Structural Adjustment Programmes—see Part VI of this book—led to a new 'enabling policy framework' with the 'liberalization' and opening up of economies where restrictions and government interventions have been increasingly done away with opening the doors to global capital. With IFIs and large corporations, along with of course, political actors as well,[75] determining the economic and political agenda of countries, the powers of the nation-state have been significantly eroded, giving way to the influence of international institutions. As a result, the power of the state has been drastically reduced and it is less able to regulate and make policies pertinent to its own country. The Keynesian welfare state or the strong developmentalist state of the late twentieth century, able to determine national policy over vital economic and social life, has been waning.

Now, external and non-elected officials—of the IMF, World Bank, other donors—play a major role in shaping macroeconomic and social decisions that affect the basic structure of the economy and living standards of nations. Today, in many parts of the world—including Pakistan, as Part VI of this book shows—officials from these agencies decide on government spending, property relations (private versus public ownership), development strategies and many other decisive aspects of social existence bypassing the electoral system of countries. These global agencies have usurped power from states and local governments and have deprived the state of the nation's sovereignty.

There have also been countries which have restricted the role of IFIs while still being major players—and beneficiaries—of globalization. India and Malaysia come to mind, where both are growing global players, yet they have set their own terms in negotiations with the transworld governance agencies, and have prospered as a result. What seems to play a key role in determining the country's ability to take on these IFIs, is an

active and political civil society and political groups (as in India) and/or strong nationalistic leadership (as in Malaysia). Pakistan, sadly, has neither.

Trade, one of the key instruments of globalization, does have a great number of benefits and many of the East Asian countries including China, have prospered on account of this globalization. India, too, in recent years has benefitted on account of the information technology boom exporting software and other services. With world travel and communications increasing and improving, tourism in many parts of the world has emerged as an important earner of foreign exchange. There has been some transfer of technology to countries where multinational corporations have shifted manufacturing, as in the case of Mexico, so as to cut costs. Those countries which have had a highly skilled and educated workforce have benefitted far more than those countries where skill and literacy levels are low. Also, more peaceful, less corrupt, and perhaps more democratic countries, may have prospered more on account of globalization than countries like Pakistan which has neither been peaceful nor democratic. One must not forget either, that globalization, particularly of capital—hot money—has had a devastating effect on many countries in the 1990s—Mexico, Argentina, and countries in East Asia.

One of the major objections to globalization by demonstrators in Seattle, Prague, Bangkok, and other sites has been that it is an unfair system in an unequal world. There is no 'level playing field', and developed countries, particularly the US, European Union, and Japan, determine the rules of the game. In many cases, the rules and regulations that these Big Three along with the IFIs, enforce on underdeveloped countries, are not followed through in their own countries. The IFIs and these countries insist that subsidies to different sectors in underdeveloped countries and protection or special privileges be done away with, yet fail to follow suit. Economist Joseph Stiglitz who won the Nobel Prize reveals the extent of these subsidies in Europe and the US and says: subsidies in advanced countries exceed the total income of sub-Saharan Africa—around *$1 billion a day*! the average European subsidy per cow matches the $2 per day poverty level on which billions of people barely subsist; and, America's $4 billion cotton subsidies to a mere 25,000 well-off farmers brings misery to 10 million African farmers.[76] On average, it has been estimated that the prices these farmers receive for their output are 31 per cent above what they will get in international trade. Farmers receive 80 per cent higher prices for milk, 100 per cent more on sugar, and 360 per cent for rice, all behind high tariff walls. So much for free trade. Undoubtedly, not a level playing field (see Box 9.7).

There is no way one can escape globalization, and perhaps there is no need either. Globalization has led to deindustrialization in some countries as well as increased capital formation in others. Exports have increased in some, while imports due to lower tariffs have increased in others. The domestic economic, social—particularly education, skill, and infrastructure—and political arrangements (civil and governmental) determine how individual countries negotiate and benefit from globalization (also see Box 9.8).

9.5.2 Globalization and WTO's Impact on Pakistan

Much of Part VI of this book, on structural adjustment, and many of the chapters elsewhere, is on Pakistan's interaction with globalization in the guise of the IFIs mentioned above. Without a doubt, the impact of globalization on Pakistan's economy, has been significant, both positive as well as negative. Even in the case of the industrial sector as we show (Chapter 7), the economy has been affected since 1988 by following policies of liberalization, a key component of globalization. Although Pakistan's economy has been far more open and more liberal, and for longer, than most others—compared to India, for example—it has since 1988 reached a higher plane altogether. Since this theme has been discussed in numerous contexts in this book, in this section we merely look at some important aspects which affect Pakistan's economy under the guise of globalization and as a consequence of the World Trade Organization agreements which came into existence after 2005—the WTO came into existence in 1995.

Pakistan, like all countries of the world, has implemented the provisions of the World Trade Organization guidelines and agreements. Trade and industrial sectors have undergone radical change in compliance, first with the Structural Adjustment Programmes of the IMF and World Bank, and more recently, in compliance with GATT and WTO rules and regulations. These rules provide a legal framework for international commerce and there are various protocols which affect different sectors.

Countries were required to improve access to foreign goods and markets by reducing/eliminating tariffs and abolishing quotas. In addition, subsidies both on exports, credit, and on domestic goods—as we argue in the section above—were to be eliminated and countervailing and anti-dumping measures taken. Let us see how these measures have affected Pakistan's textiles, which constitute more than 60 per cent of its exports—also see Chapter 8 Section 8.3, for far more details on the Textile Industry.

International trade in textiles and clothing has been subject to quantitative restrictions in industrial countries. Historically, these restrictions were governed by the Multi Fibre Agreement (MFA) which started in 1974 and was last extended up to 31 December 1994. Following the Uruguay Round of multilateral trade negotiations (1986–1994), the WTO Agreement on Textiles and Clothing (ATC) came into force from 1 January 1995. It envisaged a transitional period of ten years till 31 December 2004 by when the MFA restrictions on textiles and clothing were phased out in four phases. From 1 January 2005, the entire textiles and clothing sector was integrated with General Agreement on Tariffs and Trade (GATT) 1994 and all restrictions on imports of textiles by any of the WTO members, were to have come to an end, opening up the textiles sector on the basis of a 'free' market and 'free' movement of goods and services. The ATC principle, in essence was to remove all quantitative restrictions by industrial countries on imports of textiles and clothing from all countries, allowing far greater access to exports from developing countries such as Pakistan, bringing in a new,

Box 9.7

Globalization and its Discontents

Nobel Prize winner for Economics in 2001, Professor Joseph Stiglitz, has been a critic of the way globalization has taken place and the way it has been made use of by developed countries. Some excerpts from his writings.

> The critics of globalization accuse Western countries of hypocrisy, and the critics are right. The Western countries have pushed poor countries to eliminate trade barriers, but kept up their own barriers, preventing developing countries from exporting their agricultural products and so depriving them of desperately needed export income. The United States was, of course, one of the prime culprits. . . .
>
> But even when not guilty of hypocrisy, the West has driven the globalization agenda, ensuring that it garners a disproportionate share of the benefits, at the expense of the developing world. It was not just that the more advanced industrial countries declined to open up their markets to the goods of the developing countries—for instance, keeping their quotas on a multitude of goods from textiles to sugar—while insisting that those countries open up their markets to the goods of the wealthier countries; it was not just that the more advanced industrial countries continued to subsidize agriculture, making it difficult for the developing countries to compete, while insisting that the developing countries eliminate their subsidies on industrial goods. Looking at the 'terms of trade'—the prices which developed and less developed countries get for the products they produce—after the last trade agreement in 1995 (the eighth), the *net* effect was to lower the prices some of the poorest countries in the world received relative to what they paid for their imports. The result was that some of the poorest countries in the world were actually made worse off.
>
> Western banks benefitted from the loosening of capital market controls in Latin America and Asia, but those regions suffered when inflows of speculative hot money (money that comes into and out of a country, often overnight, often little more than betting on whether a currency is going to appreciate or depreciate) that had poured into countries suddenly reversed. The abrupt outflow of money left behind collapsed currencies and weakened banking systems. The Uruguay Round also strengthened intellectual property rights. American and other Western drug companies could now stop drug companies in India and Brazil from 'stealing' their intellectual property. But these drug companies in the developing world were making these life-saving drugs available to their citizens at a fraction of the price at which the drugs were sold by the Western drug companies. . . .
>
> Not only in trade liberalization but in every other aspect of globalization even seemingly well-intentioned efforts have often backfired. When projects, whether agriculture or infrastructure, recommended by the West, designed with the advice of Western advisers, and financed by the World Bank or others have failed, unless there is some form of debt forgiveness, the poor people in the developing world still must repay the loans.
>
> If, in too many instances, the benefits of globalization have been less than its advocates claim, the price paid has been greater, as the environment has been destroyed, as political processes have been corrupted, and as the rapid pace of change has not allowed countries time for cultural adaptation. The crises that have brought in their wake massive unemployment have, in turn, been followed by long-term problems of social dissolution—from urban violence in Latin America to ethnic conflicts in other parts of the world, such as Indonesia.

Source: Joseph Stiglitz, *Globalization and its Discontents* (London: Allen Lane, 2002), 6–8.

forceful, era of global competition. It was felt that the new regime would have a significant impact on countries which were enjoying secured market access which they would no longer have; on the other hand, countries which were being constrained by quotas would now be able to enhance market access under the new, 'free', regime (also see Box 9.9). The quota regime was expected to be over, once and for all.

Before we see how this has had an impact on Pakistan, let us briefly look at what the old regime of restrictions and reforms was like. First of all, the incidence of protection in industrialized countries for textile and clothing has been much higher than other manufactured products. On average, these tariffs were three or four *times* those on other manufactured products, with tariffs increasing with each stage of processing.[77] Average tariffs on fibres were about 1 per cent, while on clothing often more than 20 per cent.

Musleh-ud-Din and Kalbe Abbas present a very interesting analysis of what the earlier MFA tariff and quantitative regime was doing. They argue that the MFA had restricted potential imports into major industrial markets and that growth in volume of textiles and clothing exports of developing countries had been slower because of the agreement. They make numerous important points and say: 'Countries that are efficient producers of textile and clothing products have been particularly vulnerable to the imposition or tightening of MFA quotas. . . . Other effects of the MFA include trade diversion to less restricted countries away from competitive suppliers. . . . The rigidities of the quota system under the MFA have also enabled traditional suppliers to maintain their market shares despite declining competitiveness, and thus have prevented more efficient new entrants from competing on equal terms'.[78]

Box 9.8

Trade Liberalization and the Indian Industry: Some Illustrations of Adverse Impact

The liberalization of trade regime over the past years has sparked off the process of efficiency-seeking restructuring of the Indian industry. In the process a number of industries have also been adversely affected. In particular, the recent phase out of the QRs has affected adversely a large number of small-scale industries that manufacture items reserved for small-scale units. It has been estimated that about 400,000 small and medium industries have closed down in India due to their inability to face competition from imports. The Strategic Management Group in the PMO has apparently identified 45 product groups whose imports have increased sharply following the liberalization. The government is taking action to safeguard the country's interests wherever necessary.

Some illustrative cases of surging imports adversely affecting the local industry are noted below.

- *Watches and clocks*: Unable to face competition from cheaper imports, a number of well established manufactures have closed down. These include Jaina Time Industries, Bifora, Allwyn, Timestar, and Action. Ajanta is shifting production to China.
- *Electrical fittings and other household electrical goods*: Owing to a sharp increase in cheaper Chinese goods, over 300 factories making electrical goods have reportedly closed down.
- *Toys*: Imports of Chinese toys that are cheap, have wide variety, and better quality have critically affected the Indian toys industry. Many units have closed down, some are working at much lower capacity utilization than earlier. Many of the toys manufacturers have turned traders dealing in Chinese toys.
- *Dry and lead acid batteries*: Chinese dry batteries cost a fraction of locally produced ones. Similarly lead acid batteries imports from Bangladesh are cheaper than the cost of materials going into them. Obviously the local manufacturers of these have been hit.
- *Acrylic fibre, yarn and PP/HDPE woven fabric*: Taking advantage of free trade agreement with India, Nepal has captured 12 per cent of India's acrylic yarn market. Acrylic fibre imports from Nepal have increased from just 2,500 tonnes in 1997 to 12,000 tonnes in 2000. About 1,000 tonnes of woven PP/HDPE fabric sacks is also coming from Nepal every month that is about 40 per cent cheaper than (locally produced one. JK Synthetics has downed shutters while Indian Acrylics, IPCL, Pashupati Acrylon, Vardhman Acrylics and Consolidated Fibre & Chemicals are cutting capacity utilization.
- *Banaspati and edible oils*: Nepalese manufacturers import edible oils from Malaysia at negligible duties, process them into vanaspati and export it to India which works out to be at least Rs. 4 per kg cheaper than the locally produced one. Capacity utilization of Indian units has been reduced to 25 per cent.
- *Copper wire rods*: An estimated 32,000 tonnes of copper in various forms is entering India from Nepal where the duty rate on it is low at 5 per cent (compared to 38.5 per cent in India). It is affecting the local producers, viz. Birla Copper, Hindustan Copper, and Sterlite [Industries (India) Ltd.] in terms of their capacity utilization.

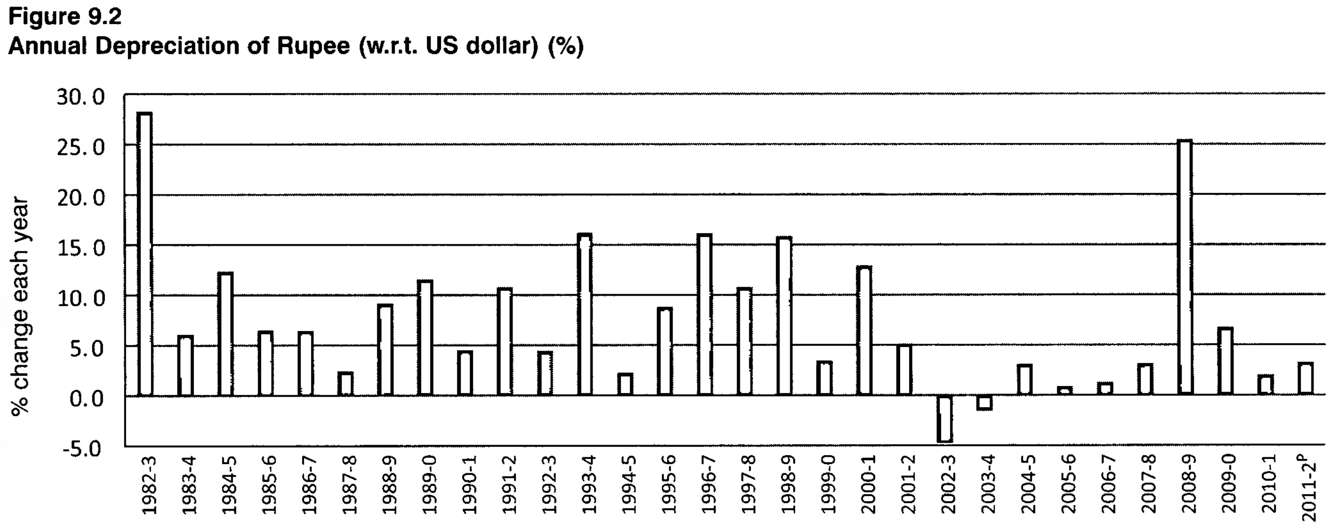
Source: Research and Information System for the Non-Aligned and Other Developing Countries, *South Asia Development and Cooperation Report 2001/02*, New Delhi, 2002, 65–66.

The Pakistan government loosened government controls on cotton exports under WTO commitments. The All Pakistan Textile Manufacturers Association (APTMA) argued that the unrestricted export of cotton would deprive the spinning industry of raw material and push up production costs to uneconomic levels. Since most countries have removed trade barriers (i.e. import restrictions) and as quotas were removed from other garment and made-up producing countries as well, it was anticipated that there would be greater demand for Pakistani yarn and fabric and therefore, there would be even less cotton available for local producers. According to WTO rules, the government is not in a position to intervene either in terms of discouraging exports of cotton, yarn, or fabrics, or provide subsidies to garments and made-up exports. The fear that textile manufacturers had was that their industry would suffer and Pakistan would lose out on valuable exports. However, it is was also considered possible that farmers, or at least owners of large land on which cotton is grown, would benefit by access to the free market.

One argument put forward by many Pakistani policymakers and industrialists at that time, was that after 2005 when a quota-free world takes over, Pakistan's main exports, textiles, would get a huge boost as there would be an increase in Pakistan's exports not restricted to quotas as it was earlier. On the face of it, this argument made a lot of sense, after all, the argument went, developed countries earlier bought only a certain amount of Pakistan's textiles constrained by set quotas. In addition, there were those in Pakistan who argued that quotas in Pakistan were being sold at a premium in the black market since there was perceived to be a shortage of quotas, and this premium was borne as an additional cost to textile exporters and in some cases was considered to constitute a major part of the exported item's price. Both these factors suggested that Pakistan's textiles would increase as one element of costs would fall and there would be greater demand. But, this is only one side of the picture.

First of all, Pakistan is not the only country which has had quota restrictions removed—all countries, including Pakistan's main competitors China, India and Turkey, can sell as much as they possibly can. In fact, one argument was made that Pakistan should be grateful for the existence of a quota regime because it limits imports from competitors

Figure 9.2
Annual Depreciation of Rupee (w.r.t. US dollar) (%)



P = Provisional
Source: The data for the graph is taken from Government of Pakistan, *Pakistan Economic Survey 2011/12 Islamabad*, 2012
Positive and negative values denote depreciation and appreciation, respectively.

like China and India, and allows at least some Pakistani textiles to get through. A quota-free regime meant increased competition and only the best and cheapest products would compete and sell. There was no guarantee that Pakistan could meet the new standards and one was not in a position in 2005, before the lifting of quotas, to say for sure that Pakistan's exports would increase; they could also have fallen (also see Appendix 9.3).

There were dozens, if not scores, of studies which looked at the anticipated impact of the fuller imposition of WTO rules and agreements on Pakistan, and a large majority warned that globalization and further expansion of the WTO umbrella would have a very negative impact on Pakistan's main exports. This has clearly not been the case and Pakistan's textile exports have expanded, given the constraints and issues mentioned in an earlier section. Imports have certainly increased a great deal, including of consumer goods, but as we argue above, the main commodities imported into Pakistan, have not been luxury items or consumer goods, but industrial raw material and, of course, petroleum products. There has not been much research after 2005 on the impact of globalization and WTO rules on Pakistan's exports, but impressions and evidence suggests that perhaps the impact may not have been as devastating as many feared. The world seems to have benefitted from economic globalization, although there are serious negative consequences, both of a political and economic nature—see Appendix 9.3 and 9.4. Moreover, it is also clear, that developed countries still have the power and dominance in a highly unequal world, to impose quota restrictions and construct other barriers which restrict imports from developing countries. While tariff and quantity restrictions have been somewhat done away with under the WTO regime, new forms of non-tariff barriers have been imposed. Sanitary and environmental standards have been imposed, as they were some years ago in the case of Pakistan's surgical goods exports. Social barriers or those pertaining to child labour or other kinds of restrictions can circumvent the no-barriers provision. Political, rather than economic or trade-related, factors have come to dominate the new, free trade, world order—see Appendix 9.4. Also see Box 9.10 for how Pakistan's exports have failed to diversify while other countries have shifted to higher value added products.

9.6 Summary and Further Reading

9.6.1 Summary

Pakistan's trade pattern has changed dramatically since 1947. From being a primary goods exporter, Pakistan now exports primarily manufactured and semi-manufactured commodities. However, its exports are still critically dependent on cotton, which contributes around 65 per cent to exports. From about 11 per cent of GDP in 1947, exports and imports together now amount to around 35 per cent of GDP. Remittances have played an important role in Pakistan's economy since the late 1970s, and once provided as much as 10 per cent of GDP; their role has since diminished, albeit is still considerable and they now usually account for around 6 per cent of GDP.

The rupee has depreciated markedly in the last many years, since the exchange rate was Rs. 9.9 to one US dollar. Since it was allowed a managed float, the annual devaluation of the rupee has been, on average, 8 per cent a year, fluctuating between 2 per cent in one year, and as much as 16 or 17 per cent in another year. Given the nature of Pakistan's macroeconomy, its inflation rate, fiscal deficit, and adherence to the Structural Adjustment Programme, one can expect a continuous drift in the value of the Pakistani rupee into the future.

Box 9.9

Agreement on Textiles and Clothing (ATC) and South Asian Textiles and Garments Exports: A Case Study of Pakistan

Developing countries and, in particular, the South Asian countries have a comparative advantage in textiles and clothing. However, their exports of textiles and clothing have been subject to a high degree of protectionist treatment. Developed countries have been following a restrictive trade regime of high tariffs and non-tariff barriers in relation to the textiles and clothing industry. The Multi-Fibre Agreement (MFA allotted quotas to regulate imports of textiles and clothing into developed countries from developing countries. MFA applies to 80 per cent of the world textile and clothing exports, with around 40 participants and 100 bilateral restraint agreements. MFA quotas have thus led to a loss in the export earnings of developing countries.

MFA was aimed at providing 'temporary' protection to developed countries' home industries and at providing 'orderly' access to developing countries entering the developed country markets. Moreover, prior to the Uruguay Round, the tariffs on textiles and clothing averaged 18 per cent for developed countries compared to 6 per cent for other manufactured products. These tariffs also increase with the value-addition, being 1 per cent on fibres and 20 per cent on clothing.

As per the WTO Agreement on Textiles and Clothing (ATC), MFA in textiles and clothing is to be phased out in four steps within 10 years starting from 1 January 1995. As a part of the implementation of ATC, the developed countries will have to eliminate these quotas, even though it is back-loaded with most of the liberalization to be carried out at the end of the period. This leaves room for discretion in their phase-out schedules. The Agreement requires that importing countries should include at least one product from each of the four groups—tops and yarns, fabrics, made-up textiles, and clothing—to make the transition more even. The Agreement also has transitional safeguards for unexpected surges in imports which are not yet integrated into the GATT framework. However, keeping in mind the interests of developing countries, these safeguards can only be applied selectively and for a maximum of 3 years. ATC also provides for a reduction of 22 per cent in industrial countries' bound tariffs. This will reduce the proportion of developed country imports subjected to peak tariffs from 35 per cent of the pre-Uruguay Round to 28 per cent. This is much lower than the proportional tariff cuts in bound tariffs which are applicable for the other industrial products.

Thus, it is clear that implementation of ATC offers great potential to developing countries for an increase in their exports of textiles and clothing. However, it also poses a challenge: With the elimination of quotas, the South Asian countries will be competing freely with other countries, some of which might be more competitive. Hence, the South Asian countries may lose their market share unless adequate steps are taken to strengthen their competitiveness. In this context, Pakistan's case study is illustrative.

The textiles and clothing sector in Pakistan is an important segment of the economy. It accounts for 8 per cent of GDP and 30 per cent of the value-added and 40 per cent of the labour force in the manufacturing sector, and over 75 per cent of merchandise exports. The rapid expansion of the industry has been facilitated by the availability of raw cotton and cheap labour. While the number of spindles doubled from 3,226 to 8,356 between 1972–73 and 1998–99, the number of looms actually fell by half from 29 to 10 over the same period.

Pakistan's textiles and clothing are exported largely to the western countries. North America is a major market and accounts for more than 50 per cent of the exports of hosiery, towels, and made-ups. Similarly, about 49 per cent of the readymade garments are exported to the United States and Canada. Next comes Europe in the export of cotton fabrics, ready-made garments, hosiery, towels and made-ups. Asia accounts for 66.36 per cent of the cotton yarn exports.

The phase-out of MFA quotas under ATC poses a big challenge of the industry and has critical dimensions for the economy and its export earnings. It requires the country to take steps to improve, consolidate and strengthen its competitiveness by improving efficiency. Pakistan does have the traditional advantage in raw cotton availability but has not yet exploited it to the maximum potential. The low level of MFA quotas being used show that all is not well with the domestic textile sector. Some of the challenges faced by the Pakistani textiles and clothing industry are as follows:

- There is a need to improve quality standards of all its textiles from raw cotton to finished products. Efforts have to be made at improving the quality of domestic cotton through greater R&D so as to develop superior varieties of long staple cotton.
- The industry should diversify its base from cotton products to synthetics to take into account the consumption pattern of the major export markets. There is a growing market for manmade fibre and products which should be tapped by increasing the production capacity of synthetic blends.
- The main focus of attention should be value-addition instead of intermediate and raw products. This requires a strong and modern weaving and processing base with a vertical integration of textile units.
- Efficient utilization of resources as well as increasing the productivity and efficiency of the industry.

Besides steps taken at the domestic level, intra-regional co-ordination based on specialization and vertical integration among the South Asian countries may help in strengthening the competitiveness of their exports of textiles and garments by enabling them to benefit from economies of specialization and scale.

Source: Research and Information System for the Non-Aligned and Other Development Countries, *South Asia Development and Cooperation Report 2001/02*, New Delhi, 2002, 93.

Box 9.10

Pakistan's Falling Exports and Rising Exports of Other Developing Countries

While Pakistan's exports have stagnated over the years and have been stuck in a singularly textile mode, other countries in the region have performed far better. The *Fourth Annual Report* of the Institute of Public Policy, Beaconhouse National University, Lahore, brings this point out clearly.

Over time Pakistan has steadily lost ground in manufactured exports to all other major developing countries: its share in this group was 1.4 per cent in 1980 but had fallen to 0.4 per cent by 2008. Even excluding China, Pakistan's share has dropped more than 50 per cent to 0.4 per cent over 1980–2008 (see Table 1). There are three main factors for this relative decline and missed opportunities. First, Pakistan remains heavily dependent on relatively slow growing textile exports—it has also made less headway in faster expanding garment exports. Secondly, since 2005, it has lost market share in both textiles and clothing not only to China but also to emerging important exporters like India, Turkey, and Vietnam. (see Table 2) Third, its record in fast expanding other manufactured exports whether sports goods, surgical equipment, automotive parts, or jewellery has been dismal and its presence in international markets is negligible. Pakistan missed out on purely non-cotton textiles in the 60s due to its restrictions and high import duties on inputs for mixed or synthetic textiles. It missed on electronics in the 60s and 70s and information technology in the 1990s. Lack of structural changes has been responsible for slow growth as well as low value added in exports.

There is some satisfaction that textile and clothing exports at the annual rate of $12.5 billion in July–December 2010 showed an improvement of over 25 per cent over the corresponding period last year. But this represents largely a recovery from the low level in 2009. More importantly, a significant part of the improvement is due to the much higher prices of cotton and cotton goods in recent months.

How far we have fallen in the export field, compared to some of our peers and competitors, is also clear from Table 3 on the trend in exports of goods and services and the share of exports in GDP. Just three decades ago, Pakistan had greater export orientation than any of the countries in the table. Now, even the two continental economies, India and China, have a much larger export sector than Pakistan. Turkey, an inward looking economy in 1980, has transformed itself.

Vietnam a new comer to the export field is now far ahead of Pakistan in just a couple of decades. In real terms, adjusted for rise in international prices, Pakistan's exports are estimated to have grown by an average of 4.5 per cent per annum since 1980 compared to 9 per cent annual growth in India—certainly not a stellar performer in the export field.

As a late comer to the field of manufactured exports, except in textiles and clothing, Pakistan faces formidable challenges. But, there are several grounds of optimism. First, Pakistan's market share in the world manufactured goods other than textiles and clothing is miniscule. Secondly, though right now Pakistan is not very competitive in textiles and clothing, the room for productive improvements is immense provided the right investments in modernizing industry and upgrading skills are made with the help of foreign partners. Pakistan should look for help to China as well as countries like South Korea, Malaysia, Turkey, and Hong Kong that increasingly face limits on their textile and clothing exports because of rising wage costs. Thirdly, proximity to China and India, the two fastest growing markets in the world, offer great long-term potential though right now there are political obstacles in the way of expanding trade with India, and Pakistan actually has a large trade deficit with China. Finally, the potential of agricultural exports has not even begun to be explored seriously.

Table 1
World manufactured exports and major developing countries' market share

	US$ Billion		Market Share (%)		
	1980	2008	1980	2005	2008
China	8.7	1329.6	0.80	9.6	12.7
Hong Kong	18.0	348.0	1.60	3.8	3.3
South Korea	15.7	365.0	1.43	3.5	3.5
Singapore	8.3	236.9	0.76	2.5	2.3
Taiwan	17.4	222.3	1.59	2.4	2.1
Mexico	4.4	212.3	0.40	2.3	2.0
Malaysia	2.4	129.9	0.22	1.4	1.2
Thailand	1.6	127.2	0.15	1.2	1.2
India	5.0	112.2	0.46	0.96	1.07
Brazil	7.5	86.4	0.69	0.85	0.83
Turkey	0.8	103.8	0.07	0.82	0.99
Indonesia	0.5	52.7	0.05	0.54	0.50
Philipines	2.1	40.5	0.19	0.50	0.39
Veitnam	–	32.7	–	0.22	0.31
Pakistan	1.3	14.9	0.12	0.18	0.14
Bangladesh	0.5	13.5	0.05	0.12	0.13
Total for above countries	94.1	3427.8	7.82	30.88	32.78
World Exports	1,092.4	10458.1	100.0	100.0	100.0

Source: WTO Statistical Tables
Note: Figures for Singapore, Bangladesh and Vietnam relate to 2005

Table 2
Textiles and clothing exports of major developing countries

	Textile Exports		Clothing Exports		% Change in Exports	
	2005	2008	2005	2008	Textile	Clothing
China	41.1	65.3	74.2	120.0	59.0	61.8
Hong Kong	13.8	12.3	27.3	27.9	−11.2	2.3
South Korea	10.4	10.4	2.6	1.7	−0.2	−32.5
Maxico	2.1	2.0	7.3	4.9	−6.8	−32.8
Malaysia	1.4	1.5	2.5	3.6	14.2	46.2
Thailand	2.8	3.2	4.1	4.2	16.2	3.8
India	8.3	10.3	8.6	10.9	23.9	26.3
Turkey	7.1	9.4	11.8	13.6	32.8	14.9
Indonesia	3.4	3.7	5.0	6.3	9.6	26.7
Philippines	0.3	0.2	2.3	2.0	−27.9	−13.5
Vietnam	0.7	1.6	4.7	9.0	126.1	91.6
Pakistan	7.1	7.2	3.6	3.9	1.4	8.4
Bangladesh	0.7	1.1	6.9	10.9	54.6	58.5
Total for Above Countries	99.0	128.1	160.8	218.9	29.4	36.2
World Exports	204.3	250.2	277.1	361.9	22.4	30.6

Source: WTO Statistical Tables
Note: Figures for Singapore, Bangladesh and Vietnam relate to 2005.

Table 3
Exports of goods and services ($ billions)

	1980	2000	2008	2009
Bangladesh	1.0	7.2	17.5	17.0
	(5.0)	(14.0)	(20.0)	(19.0)
China	–	279.6	1581.7	1333.3
	(11.0)	(23.0)	(35.0)	(27.0)
India	11.3	59.9	302.8	258.8
	(6.0)	(13.0)	(24.0)	(21.0)
Pakistan	3.2	10.1	25.5	22.2
	(12.0)	(13.0)	(13.0)	(13.0)
Turkey	3.6	50.3	175.8	142.8
	(5.0)	(20.0)	(24.0)	(23.0)
Vietnam	–	17.1	69.7	62.9
	–	(55.0)	(78.0)	(68.0)

Figures in parenthesis give share in GDP
Source: World Bank Data

World manufactured exports and major developing countries' market share

	1980	2008	1980	2005	2008
China	8.7	1,329.6	0.80	9.6	12.7
Hong Kong	18	348.0	1.60	3.8	3.3
South Korea	15.7	365.0	1.43	3.5	3.5
Singapore	8.3	236.9	0.76	2.5	2.3
Taiwan	17.4	222.3	1.59	2.4	2.1
Mexico	4.4	212.3	0.40	2.3	2.0
Malaysia	2.4	129.9	0.22	1.4	1.2
Thailand	1.6	127.2	0.15	1.2	1.2
India	5.0	112.2	0.46	0.96	1.07
Brazil	7.5	86.4	0.69	0.85	0.83
Turkey	0.8	103.8	0.07	0.82	0.99
Indonesia	0.5	52.7	0.05	0.54	0.50
Philippines	2.1	40.5	0.19	0.5	0.39
Vietnam	–	32.7	–	0.22	0.31
Pakistan	1.3	14.9	0.12	0.18	0.14
Bangladesh	0.5	13.5	0.05	0.12	0.13
Total for above countries	94.1	3427.8	7.82	30.88	32.78
World Exports	1,092.4	10,458.1	100	100	100.00

Note: Figures for Singapore, Bangladesh, and Vietnam relate to 2005.

Textiles and clothing exports of major developing countries

Country	Textiles Exports		Clothing Exports		% change in Exports	
	2005	2008	2005	2008	Textiles	Clothing
China	41.1	65.3	74.2	120.0	59.0	61.8
Hong Kong	13.8	12.3	27.3	27.9	−11.2	2.3
South Korea	10.4	10.4	2.6	1.7	−0.2	−32.5
Mexico	2.1	2.0	7.3	4.9	−6.8	−32.8
Malaysia	1.4	1.5	2.5	3.6	14.2	46.2
Thailand	2.8	3.2	4.1	4.2	16.2	3.8
India	8.3	10.3	8.6	10.9	23.9	26.3
Turkey	7.1	9.4	11.8	13.6	32.8	14.9
Indonesia	3.4	3.7	5.0	6.3	9.6	26.7
Philippines	0.3	0.2	2.3	2.0	−27.9	−13.5
Vietnam	0.7	1.6	4.7	9.0	126.1	91.6
Pakistan	7.1	7.2	3.6	3.9	1.4	8.4
Bangladesh	0.7	1.1	6.9	10.9	54.6	58.5
Total for above countries	99	128.1	160.8	218.9	29.4	36.2
World exports	204.3	250.2	277.1	361.9	22.4	30.6

Note: Figures for Singapore, Bangladesh, and Vietnam relate to 2005.
Source: The Institute of Public Policy, *The State of the Economy: Devolution in Pakistan*, Fourth Annual Report 2011 (Lahore: Institute of Public Policy, Beaconhouse National University, 2011), 28–30.

Just as the industrial policy of the early years was maligned for causing inefficiencies in the economy, so too was trade policy. The same reasons were given for distortions being caused in the structure of the economy by trade policy, as were alleged to have resulted from industrial policy. However, this chapter, reviewing the work of some scholars, has argued that many of the so called distortions had export-enhancing impacts, and that these measures were productive. The Bonus Voucher Scheme of the 1960s, in particular, was singled out as a mechanism that caused serious distortions in the economy. However, as this chapter has shown, the scheme was conducive to promoting industrialization and exports.

Pakistan's trade pattern and trade policy have continuously been moving towards fewer and fewer controls, lower tariffs, and more openness. Non-tariff barriers have been replaced by tariffs, and tariff rates have come tumbling down. Since 1988, as per the agreement with the IMF and the World Bank under the Structural Adjustment Programme, a 'liberal' import policy has been pursued, with lower tariff rates and fewer tariff slabs, along with a persistent 'readjustment' of the Pakistani rupee. Despite the substantial devaluation that has taken place, Pakistan's exports have not responded as one would have hoped.

Export-led growth is considered to be a key ingredient in economic development as the much-cited East Asian miracle suggests. However, the important factor overlooked by Pakistan's policymakers is that the supply-side incentives—prices, inputs, tax incentives, etc.—do not help exports as much as removing structural weaknesses. Quality control, the provision of infrastructure like communications and energy, and direct incentives to exporters are all necessary to ensure that exports increase to an extent where they contribute extensively to economic development. To do that, Pakistan requires an export bias in policy, a fact that has been ignored for most years.

9.6.2 Further Reading

Since industrialization and trade are so closely linked, many of the references given in Chapters 6–8 should also be studied to understand how trade influenced industrialization in Pakistan. On Pakistan's trade: Adams, Adams and Sabiha Iqbal, *Export Politics and Economic Development in Pakistan* (Lahore: Vanguard, 1987); see also Viqar Ahmed and Rashid Amjad's *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984). Some references in the Notes will also be useful for additional reading on trade.

Appendix 9.1

The World Trade Organization

The following is an edited extract from a report by the Export Promotion Bureau in 1995.

> It all began in the Latin American resort town of Punta del Este, Uruguay. And it seemingly ended in Marrakesh in April 1994. Seemingly, because now is the real beginning of the outcome of the talks that commenced in Uruguay in 1986.
>
> On 1 January 1995, a new organization came into existence—the World Trade Organization (WTO). This new organization replaces the General Agreement on Tariffs and Trade (GATT) and will supervise and oversee the most ambitious global trade accord ever.
>
> What is this GATT accord and how is this likely to affect Pakistan's exports?
>
> The Uruguay Round of trade talks ended with the signing of an accord that is about 500 pages long which contains resolutions that affect a wide variety of subjects both directly and indirectly.
>
> The signing of this accord could allow Citibank to open more branches in Pakistan. It could result in the closing up of thousands of factories across the country because of accusations of environmental pollution. It could reverse our efforts to make Pakistanis computer literate. It could threaten our carpet exports because of social dumping. It could rake in profits for our garment and footwear exporters. The list goes on.
>
> But like all agreements, the WTO Agreement has its loopholes and provisos, its qualifications and conditions and its Schedule of Commitment which can help protect infant industries and restrict market access.
>
> So, did the Marrakesh Agreement achieve nothing more than a 'new and improved' label? The answer depends on how the world implements the accord.
>
> **Objectives of the WTO Agreement**
>
> > Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development,
> >
> > Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development,
> >
> > Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous

arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations. . . .

A group of 117 countries agreed on 15 April 1994 to set up a World Trade Organization to implement, administer, operate and further the objectives of the multilateral trade accord.

The basis of the WTO Agreement is the premise that free trade is good for all. By lowering tariffs and quotas the playing field will be levelled and everyone will have the opportunity to compete in a free world market.

Studies have estimated that by removing restrictions, world income is likely to grow by over $200 billion a year by the year 2002. This growth will be shared by all countries, albeit disproportionately—the developing countries are likely to experience slower growth in their income.

Salient features of WTO Agreement

The GATT accord is expected to reduce tariffs around the world by an average of about 40%. This will make consumers happy because prices of imported goods will decrease. It will make exporters glad because reduced prices will stimulate increased demand for their exports. However, developing country industrialists with large excess capacity or inefficient plant and management who were previously protected by prohibitive import duties will have to face price as well as quality competition.

According to the WTO agreement, developed nations which were restricting the import of textiles and clothing have to phase out the Multi-Fibre Arrangement (MFA)—quantitative restrictions on the import of fibre, textiles, and apparel. Quotas are to be totally lifted over a staggered period of ten years. This will mean that Pakistani apparel exporters can sell as many T-shirts in America as US buyers want. However, restrictions on importing T-shirts from India, Bangladesh, and Hong Kong will also be removed and Pakistani shirt exporters will have to be competitively priced.

This agreement has also introduced new patent and copyright protection laws for intellectual property. We will now have to pay top dollars for computer software. Pirated software will be confiscated and destroyed. The computer revolution that is sweeping across developing countries may come to a grinding halt—unless software manufacturers in the West adopt LDC user-friendly pricing policies.

While pirate shops will have to go underground, authorized dealers of computer software and vendors of audio and video cassettes and CDs will experience a massive growth in their sales. The recent introduction of Time-Warner videos in Pakistan shows the tremendous market opportunities available. Even though Time-Warner video rental rates are over 100% higher than those of pirated videos, the introduction of a quality product has been well accepted in the market. Appropriately priced computer software can also take off.

The WTO agreement also addresses the problems of trade in services—including banking and insurance. A country cannot indefinitely limit market access to foreign firms in the service sector based on quantitative restrictions on the number of service suppliers or the total value of service transactions, or the number of service operations. For example, if a foreign bank which already exists in a country applies to open an additional branch, it is seeking market access. If the procedure for licensing of new branches is less onerous for domestic banks than it is for foreign banks, then the country can be accused of discriminatory restrictions.

WTO and tariff reductions

The results of the market access negotiations of the Uruguay Round of talks has been the agreement to reduce tariff rates on non-agricultural goods by about 40%. These rates have been annexed to the agreement in the form of national schedules of concessions.

The tariff reduction programme agreed upon is to be implemented in five equal rate reductions unless otherwise specified by a country. The first such reduction has come into effect on 1 January 1995 and the final rate is to become effective within a period of four years.

Pakistan has been very liberal in its tariff reduction and market access programme and has already announced the reduction in tariffs on several important product categories. On 1 January 1995 Pakistan slashed by 50% the tariff on an item of interest to both the US and Europe—cotton and silk fabrics. Our textile mills will now have to compete with European and US fabrics under protectionist fences that have been lowered from about 70% (plus 15% sales tax) to 35% (plus sales tax).

The government has also committed itself to reducing average tariffs from the current 70% to 45% in 1995–96 and 35% in 1996–97. Used to working under a regime of import restrictions and licensing, Pakistan's industrial sector has numerous inefficient and obsolete factories. The tariff reductions that will come into effect will result in a shake out and inefficient producers will have to shape up or close down.

Tariff reductions and government revenue

Pakistan relies heavily on indirect taxation for government revenue. Import duties and sales tax on imports account for over 40% of total government revenue and a reduction in tariffs is expected to cut heavily into this source of funds. This may exacerbate the budget deficit.

However, the government is banking on the success of its taxation reforms to bridge the gap. First, reduction in import tariffs compounded with restrictions and monitoring of Afghan Transit Trade may result in a reduction in smuggling. More imports will come in through the legal channel thereby generating import duty income for the government. Secondly, introduction of VAT—a broad based General Sales Tax—is likely to increase revenues. And, finally, greater sectoral coverage of income tax through the inclusion of agricultural income in the tax net is expected to yield sufficient revenues to bring down the budget deficit to 3% of GDP by 1996–97. If the political will to enforce all aspects of the tax reforms programme is lacking, we may end up with lower import duty collections and a yawning deficit.

The WTO Agreement and agriculture

The Uruguay Round of talks have deliberated on various aspects of the agricultural sector. This sector is heavily protected not only in developing countries but also in developed countries. Tariffs on agricultural products are to be

reduced by 36% in developed countries, 24% in developing countries. This reduction is to be undertaken over a period of 6 years for the developed countries but over 10 years for developing nations. Least developed countries are not required to reduce their tariffs.

The Japanese rice growers have a powerful lobby that almost managed to disrupt the Uruguay accords by preventing the opening up of the Japanese rice market to foreign competition. However, they later agreed to minimal market access—between 3% to 8% of domestic consumption over a ten-year period.

European Community farmers also work under heavy farm subsidies. Their subsidized output is sold in the domestic market as well as to foreign buyers. Reduction of these farm subsidies may lead to higher international food prices as subsidizers reduce the surplus that they dump overseas. Developing countries that import such food grains will suffer.

Domestic farm support policies that have a limited impact on trade are excluded from reduction commitments. Such policies include government support for research, disease control, food security, and environmental programmes. Other farm support policies which are not exempted will have to be reduced by 20% by developed countries and 13.3% by developing countries (excluding the least developed).

Direct export subsidies on farm products have to be reduced and the total quantity of subsidized exports also has to be limited. However, subsidies to reduce the cost of marketing exports of agricultural exports or inland transport and export freight charges have not been subjected to reduction. This is of significance to Pakistan as we are currently providing a 25% freight subsidy to encourage the export of fresh fruits and vegetables.

Circumvention of the agreement through food aid donations and export credits is to be controlled through certain provisions in the agreement.

As protectionist farm policies supported by strong political lobbying are expected to threaten the accord, the WTO agreement includes an agreement on Sanitary and Phytosanitary Measures. This gives governments the right to control food safety and plant protection but has to be limited to the extent necessary to protect human, animal, or plant life.

Japan's recent removal of the ban on the import of Washington apples from the United States is an example of how this policy could open up markets. What is important is that the countries which have signed up should apply these rules across the board. Succumbing to US pressure, Japan could selectively open its market for agricultural imports but phytosanitary regulations could be enforced to ward off rice imports from Pakistan.

The EC has recently stiffened its import regulations for fruit and vegetables, introducing packaging as well as quality standards. Pesticides and fungicides imported from developed countries are used in the production of fruit and vegetables in developing countries and at times residues of such products constitute grounds for barring entry. With good intentions, the WTO agreement can help resolve these problems. But if nations so desire, they can wield the quality card for discriminating against foreign imports.

An important issue related to agriculture is the protection given to intellectual property rights insofar as they apply to patents for plant varieties and 'breeder's rights'. This could mean that farmers would have to pay royalties for growing crops of a particular type even if they used their own seeds. Such royalty payments could affect the profitability of farmers in developing countries. Indigenous research into plant varieties—especially rice and cotton in Pakistan—should be speeded up to avoid heavy royalty payments.

The WTO Agreement and textile exports

World trade in textiles and clothing is heavily restricted and subjected to quantitative restrictions. The United States and Canada as well as most of Western Europe have shuttered out suppliers of clothing and textiles from Asia, Latin America, and several other regions to protect their own overpaid workers.

One of the major achievements of the Uruguay Round of trade talks is the agreement to phase out the Multi-Fibre Arrangement and put an end to quotas on textiles and clothing. The phasing out of quotas is scheduled to take place over a ten-year period in three phases. The first phase began on 1 January 1995 when the quota imposing countries lifted quotas on several items allowing the free import of a number of textile and clothing products from Pakistan.

According to the agreement, 16% of total 1990 imports of textiles were integrated into the GATT—freed from quotas—on 1 January 1995. These products are from a specific list in the agreement and have to include items from each of the following categories: fibres and yarn, fabrics, textile madeups, and clothing.

On 1 January 1998, in the second phase, an additional 17% of 1990 imports would be integrated followed by a further 18% of 1990 imports on 1 January 2002. All remaining products would be integrated on 1 January 2005.

Between each phase, the level of quotas imposed on the products that remain under restraint is to be reduced by a speedy enhancement of quota limits. According to the MFA, annual growth levels accepted for most categories are about 5–7%. These are to be increased by 16% in Phase I, by 25% during Phase II and by 27% in Phase III. This means that a product that remains under quotas for the entire duration of the ten-year phasing out period will have its quota level enhanced by 5.8% every year between 1995–98 from the existing level of 5%. In Phase II (1998–2002) the annual growth level will be enhanced to 7.25% and in Phase III (2002–2005) this will increase to 9.2%.

During the initial three years there will be a marginal opening up of the textile and clothing sector. Between 1998–2002 the level of integration will be only 33%. It is only after the seventh year of the accord begins in 2002 that 51% of the textile products under quotas will be freed. The developed countries have, therefore, delayed the opening up of their textile sector to unhindered foreign competition but they have negotiated with developing countries like Pakistan and India to lower tariff levels on imported fabrics and textile products. In fact, Pakistan has already agreed to allow the import of foreign fabrics and children's garments at a nominal tariff level of 35%. This lowering of the tariff level took effect on 1 January 1995.

Impact of the WTO Agreement on Pakistan's textile exports

Cotton yarn

Pakistan's most significant textile export is cotton yarn which accounts for about a third of all textile exports. Selling yarn has never posed a major problem and greater market access for our yarn will not lead to any significant trade gains. It is the availability of cotton which will determine growth in this sector. If cotton is available in abundant quantity, our textile spinners can convert it into yarn for both domestic sale and export.

The declining cotton crop may lead to increased usage of man-made fibres and poly-cotton yarn. Spinning mills have to be flexible enough to make both types of yarn. Besides, finer counts of yarn will be spun when cotton is not readily available. Both these point towards quality upgradation as a means of increasing export earnings.

Increased exports of textiles and apparel in a quota-free world will increase the demand for cotton yarn and push up prices which have already climbed up from an average of about $1.5 per kg to $2.75 per kg within the last two years.

In 1992-93 and in 1991-92 we doubled our textile spinning machinery imports each successive year and we now have sufficient capacity in our spinning sector to meet our domestic needs and export over $2 billion worth of yarn in 1996-97 (from the current $1.2bn) provided we have a good cotton crop.

The WTO accord may help keep yarn prices up but removal of supply constraints is important to keep our yarn exports going. In six years our yarn exports jumped up in value from $260 million in 1984-85 to $1,183 million in 1990-91. They have only remained stagnant during the last few years due to lack of cotton.

Cotton fabrics and synthetic textiles

Some cotton fabrics and synthetic fabrics are subjected to quota restrictions and it is expected that as soon as quotas are lifted, their exports will grow.

About 30% of our cotton fabrics and 50% of our synthetic textiles go to developed countries and the WTO accord may lead to an initial spurt in exports to these countries. However, increased competition from the Far East may reduce US and European apparel and textile made-up manufacturing and the fabrics being exported by Pakistan may find a bigger and growing market in the Far East or Latin America rather than in Europe or North America.

Quality improvements in the processing of fabrics will be needed to meet competition from the Far East. Colour fast printing and dyeing as well as a quantum leap in the designing of motifs and patterns will be essential for upgrading the quality of our fabric exports. Flawless weaving and strict quality control will also ensure growth of this sector.

Textile made-ups

Bedsheets, towels, and other textile made-ups supplied by Pakistan are among the cheapest in the world—barring China. Exports of most of these items are affected by quotas. The WTO agreement will provide greater market access to our exporters and we should be able to increase our exports of such products.

The current cotton crisis has pushed up the cost of raw material—yarn—for made-ups manufacturers and they are experiencing difficulties in export at their traditional low prices. What is required is that exporters of made-ups should invest in upgrading their marketing skills and cater to the higher level of the market.

Providing institutional linen in bulk—plain white towels and bedlinen—may generate export sales but dyed, embroidered. and appliqued towels fetch prices that are several times greater. Admittedly, they require more marketing efforts but they are the long term saviours. A shipment of cheap towels from China can immediately displace exports from Pakistan but a well-designed and packaged product from Pakistan will not be easily dislodged by foreign competition.

Garments and knitwear

The clothing sector possesses the biggest promise for delivering Pakistan out of the under $10 billion exporters club. Our knitted T-shirts are in great demand in the US and Europe and quotas on the export of T-shirts have been stifling growth in this sector. Once the quotas are removed we should experience a tremendous growth in the demand for a large number of our clothing goods.

However, it is unclear as to when quotas on these items will be reduced. It seems most likely that quotas on major clothing exports will only be lifted in 2005. This will mean that there will be no significant change in our exports of garments and knitwear for the next ten years.

As the phasing out of the MFA involves the lifting of restrictions of different categories during different periods, it is likely that Pakistan's exports of, for example, trousers, will become quota free while export of trousers from India and Hong Kong will continue to remain under quotas. These opportunities have to be seized and efforts have to be made to get our foot in the door as soon as possible.

There will be continued resistance from the West to our clothing exports as is evident from the following statement made by the President of the US Amalgamated Clothing and Textile Workers Union:

> [By signing] the accord without toughening its labour standards, Congress and the administration are putting millions of US jobs at risk by linking the American economy to those of countries that lag dramatically behind America in wages and work standards.
>
> [Supporting this agreement is to] rob children and young adults of their youth. The [WTO] should include mechanisms to enforce internationally recognized workers' rights, including outlawing child labour, and set environmental standards.

If such 'social dumping' or 'environmental dumping' objections are given weightage, the West will continue to have a ploy for limiting our clothing exports.

As it is, the first phase of abolishing quotas has shown that the West is planning to take the harder decisions later. By only abolishing quotas on items such as 'umbrellas' and 'fabrics for

making parachutes', it is obvious that apparel exporters need not celebrate just yet.

Long term prospects for growth in Pakistan's garment and knitwear exports, however, are quite positive. In the last five years, garment exports have grown from $394 million to $613 million while hosiery (knitwear) exports have grown from $274 million to $509 million.

The textile export sector—aided by the Export Promotion Bureau—is making investments in improving fashion designing and upgrading skills in manufacturing by setting up a dozen textile training institutes and a fashion design school. By the time quotas on the export of apparel are lifted, these institutes should have turned out enough trained professionals to meet the quality requirements of an unfettered world of competition.

Leather and leather goods exports

After textiles, leather is the most important sector of Pakistan's exports. Every year, we have been supplying over 15 million sq. metres of leather to the world, of which 3 million sq. metres goes to Italy alone—Italy's famous Gucci shoes may be made of Pakistani leather!

During the last ten years we have also developed our leather garments industry which is now generating exports of $376 million. Our footwear industry is, however, still in its infancy and is expected to take off in the next few years.

The entire leather group today contributes about 4600 million in export earnings. With some marketing and training efforts leather garments exports can grow substantially. Footwear exports can also grow dramatically if import regulations for raw material used in the footwear industry are relaxed. The leather industry has the potential to become a $2 billion export industry within five years if we continue to upgrade skills and also ensure adequate supplies of hides and skins by tapping the Central Asian markets.

Central Asia presents a very large export market for our leather products and is currently catered for by 'tourist-businessmen'. Streamlining the financial and banking arrangements between the region and Pakistan will help boost exports there.

One major problem that looms large for the leather sector is the environmental rules that infiltrate into the WTO. The WTO agreement incorporates an Agreement on Technical Barriers to Trade which covers processing and production methods related to the characteristics of the product itself. If the leather that is being exported by Pakistan is being manufactured in tanneries that spew untreated effluent into the environment, countries can restrict our leather exports.

The leather industry of Pakistan has taken cognizance of this and is already undertaking efforts to minimize ecological damage.

Food exports—rice, fruit and vegetables, and seafood

Last year, when the Japanese government opened up its rice market due to a bad rice crop it was very selective in its policy. Pakistan was unable to get a share of its market. Although we do not produce the glutinous rice that is eaten by the Japanese, we do produce rice which can be used for industrial purposes (making sake and rice noodles). 'Quality considerations' prevented the import of our rice.

The opening up of the rice market in Japan is unlikely to create any major new opportunities for us.

We should be watchful of conditions on 'quality' safeguards that will need to be taken on the export of fruits and vegetables. Traces of pesticides and chemicals—that were sold to Pakistan by the West—are posing as hurdles in our export of produce.

We have to educate our farmers on the proper usage of chemicals and a back-to-basics approach is ideal for green vegetable exports. Proper packaging and temperature controls are also needed to increase our exports of fruits and vegetables.

Fish and seafood exports are also affected by quality standards. Untreated sewage flows into the sea and is polluting our marine environment. Industrial effluents are also being dumped untreated into the sea. These, along with overfishing, have affected our fish catch. Indiscriminate use of fine mesh nets and fishing during the breeding season is reducing our fish population.

These problems need to be addressed if our fish exports are to grow. But what is more important is the quality upgradation that we have to undertake to ensure that we are not subjected to restrictive trade practices.

In early 1994, French fishermen protested against the cheap import of fish from abroad by destroying containers of imported fish. Within weeks of this incident, the French authorities asked the Pakistani government to supply them with a list of exporters of seafood whose fishing and packaging practices conform to the health and hygiene requirements of the EC.

An attempt was apparently made to bow down to domestic pressure by using the subterfuge of quality.

Our seafood exporters generally work in extremely unhygienic conditions. They have to upgrade their facilities to conform to internationally acceptable standards as the sword of quality will be used more and more aggressively in the new, liberated world of trade.

WTO and ISO 9000

When quotas on our textile exports are removed, the world will have another instrument to restrict our exports. This is the ISO 9000 rule, ISO 9000 is a new quality standard that is being espoused by the world to foster good manufacturing practices and quality safeguards in all processes both in the manufacturing and service sectors.

In Pakistan one company has so far been certified to be conforming to ISO 9000 standard—AEG. Unless other manufacturers and exporters join the bandwagon and begin standardization and quality controls, Pakistan's exports will perpetually remain under the ominous threat of quality sanctions.

Source: The Export Promotion Bureau, Uruguay Round of Trade Talks: Impact on Pakistan's Exports, Export Promotion Bureau, Karachi, 1995.

Appendix 9.2

Devaluation: Arguments For and Against

The following three articles, two written a few days prior to the 28 October 1995 devaluation, one immediately following the 12 September 1996 devaluation, examine the arguments for and against devaluation in Pakistan.

The devaluation dilemma

Business and banking circles in Karachi are abuzz these days with the prospects of an imminent devaluation. Exporters and importers, understandably alert, are hedging their bets as they believe that the Government of Pakistan is about to devalue the rupee substantially. Leading currency analysts in the city, for their part, are also predicting a massive devaluation of the rupee against the US dollar before the end of the year.

These devaluation rumours have been sweeping the market for many weeks and have intensified of late, resulting in a near panic buying of dollars. At the same time, importers have stepped up business considerably in a bid to capitalize on the higher existing exchange rate before imports become more expensive. Even the federal commerce minister, Chaudhry Ahmed Mukhtar, joined the fray a few days ago, revealing that the government intends to devalue the rupee by three per cent by the end of the year. In all this ruckus, the only quarter which has consistently taken a different stance is, in fact, the very institution that is supposed to announce changes in the value of the rupee, the State Bank of Pakistan.

State Bank Governor Yaqub has repeatedly and strongly denied all the rumours and speculation about devaluation, massive or otherwise. With statements ranging from 'no devaluation in the offing' and reports that he has 'ruled out devaluation', to the stronger 'dismissal' of the commerce minister's statement, Governor Yaqub has consistently clung to his claim that devaluation will not take place. Furthermore, he has warned those 'gambling' on a probable devaluation of the rupee to do so 'at their own risk', in the process reminding them of a similar warning issued by him when the government decided to make the rupee convertible in June 1994.

At the time, currency analysts and market players were, as is the case now, expecting a massive downward movement in the rupee and had consequently indulged in 'a pre-1994 budget buying spree to make windfall profits'. In the event, however, the rupee depreciated and adjusted by only 9.3 per cent after the partial convertibility on 1 July 1994. But despite the claims and warnings by the governor that devaluation is nowhere in sight, the fact remains that the rupee has seen as many as nine downward adjustments since the budget was announced on 14 June.

The spot buying rate of the rupee was pegged to the US dollar at 30.97 prior to the budget. The first post-budget downward movement occurred on 28 June, when it lost four paisas and settled at 31.01 rupees. In the 14 weeks from the mid-June budget to the end of September, the nine downward adjustments have resulted in a 58 paisa, or 1.87 per cent, depreciation in the value of the rupee. At the end of September, the spot buying rate of the rupee with respect to the dollar was 31.55. The Governor of the State Bank, for his part, has called this drop a 'corrective adjustment' and not a devaluation.

Bankers and currency analysts, however, are forecasting a substantial devaluation before the end of the year. They predict that the December rupee-dollar parity will be 32 rupees to the dollar at the very minimum, but will most likely be closer to the 33 rupee mark. One analyst believes that the 'most real value for the rupee before the year is out' is a massive 35 rupees to the dollar. Another view, that of a senior banker in a leading US bank, is that the rupee will depreciate by 10–15 per cent by early November. This means that his bank is advising its clients that the dollar will be worth 36.2 rupees in a few weeks, well before the end of the year.

Most analysts give four reasons for the impending devaluation, three of which relate to what are called 'fundamentals'. They believe that there is a need for devaluation because of the continued widening of the trade gap, the fall in foreign exchange reserves and mounting inflationary pressures. The fourth reason is said to be the recent adjustment in the Indian rupee. Not all of these claims are valid.

The trade and current account deficits, for instance, have both been falling over the last few years, not widening. The trade deficit in the last financial year 1994–95 as a percentage of GDP was the lowest since 1980. The current account deficit (as a percentage of GDP) for the last year, meanwhile, was the lowest since 1987 with the exception of 1991-92. The trend for the two deficits, which are very closely related to the exchange rate, has, therefore, been downward. On the other hand, foreign exchange reserves have been rising consistently since 1990, and at the end of the last financial year stood at 2.74 billion dollars, the highest level ever. On these two counts, which reveal important trends related to the exchange rate, currency analysts have got the direction of the movement wrong.

Inflation is the only fundamental on which the analysts are right, but for the wrong reasons. Inflation has been on the rise and has affected what is known as the real exchange rate, which compares the inflation rate in exporting and importing countries. High inflation in one trading country vis-à-vis the other implies a deteriorating real exchange rate, and hence the need to devalue the nominal exchange rate to make our goods more competitive. It is true that Pakistan's inflation rate is higher than that of its trading partners, but devaluation on these grounds would only add fuel to the fire. Devaluation for Pakistan would prove to be inflationary and further worsen an already explosive price situation.

The main reason extended in favour of devaluation is that it will make exports more competitive—that is, cheaper—and thereby increase the volume of exports and foreign exchange earnings. However, even at a theoretical level this is a questionable proposition. Firstly, exports may not be price sensitive and they may respond to non-price factors; as such, lowering the price of exports may not affect volume and

lead to an increase in demand. This very phenomenon was observed in Pakistan after Moeen Qureshi's devaluation two years ago. Often, a J-curve effect is seen, where the balance of trade—the value of exports minus the value of imports—first deteriorates before any improvement is seen. This often produces the knee-jerk reaction of further devaluation and only adds to existing problems.

Also, even if exports do indeed increase, the price of imports will also rise at the same time, and under numerous conditions the effect of devaluation may substantially worsen the balance of trade and negate the entire exercise. Furthermore, after the utter devastation of the Mexican economy following a bungled devaluation nine months ago, foreign investors have become more cautious about such interventions in emerging markets, and local governments are aware of these concerns.

The fourth argument for devaluation is the weakest. The justification in fashion these days is that since the value of the Indian rupee has fallen, or depreciated, to be precise, Pakistan must devalue immediately. Newspaper articles are clamouring that the 'Indian move is an economic invasion to knock out Pakistani exports in the world market'. There are numerous inconsistencies in this claim.

Firstly, Indian goods are not strictly comparable to Pakistani exports and nor are all of them perfect substitutes. Secondly, export orders and contracts are usually signed well in advance, and are based on numerous non-price considerations such as political factors, long-term dealings, practices and ties, institutional factors, tradition, culture and a host of other influences. Thirdly, Indian exports generate almost four times the foreign exchange that Pakistani exports are able to bring in, implying that the Indian market is already more established than Pakistan's. Fourthly, the devaluation seen in the Indian rupee actually took place in the kerb market, where the rupee fell to 35 per dollar for a short while, but then stabilized at around 33.80. The official value of the Indian rupee did not change.

Finally, Indian exports have surged this year, rising by as much as 29 per cent which is a very healthy trend indeed. Essentially, then, a devaluation in the Indian rupee by a few percentage points should not cause concern to our exporters. What matters for us is the US dollar.

Strangely enough, while all currency analysts and traders have been arguing in favour of devaluation, they have not given enough weight to what happens to the US dollar. Pakistan follows a managed float and although there is a basket of currencies to which the rupee is linked, the US dollar is still the key currency. This April the dollar fell to an all time low of one dollar to 80 Japanese yen, and after a 15-month high is now hovering around 100 yen. The US dollar started its upward movement in July and the changes in the dollar–Pakistani rupee rate need to be seen in that context. A stronger US dollar would put pressure on the Pakistani rupee, and hence the need for the 'technical adjustments'.

The key determinant in the next few months for the Pakistani rupee will be the value of the US dollar, not the Indian rupee. Once the dollar stabilizes, so should the rupee. Furthermore, there has been very little adjustment so far this year, mainly because the dollar was weaker, and based on past trends, there is considerable room to manoeuvre.

At the moment the government's most immediate task is to deal with rising inflation, which was 14.8 per cent in August on a year-on-year basis. Devaluation at this point will only fuel inflation without necessarily improving the balance of trade position. Exports showed a healthy trend last year growing by 15.7 per cent with a total value of 7.8 billion dollars. The target for the current fiscal year 1995–96 is 9.2 billion dollars, and if the cotton crop is good, as is very probable, one can expect an increase in exports. The stumbling block for high exports is not the rupee–dollar parity rate, but the anarchic and devastating political situation in Karachi. All attempts at improving the economy and expanding exports must be predicated on finding a quick and just solution to the politics of Karachi.

To this end, the business community should be pressurizing the government to come to terms with the real concerns of the people of this city. In comparison, the whole hype about devaluation as the key to our economic problems will soon fall into perspective.

Source: Zaidi, S. Akbar, 'The Devaluation Dilemma', *The Herald*, Karachi, October 1995.

Walking the exchange rate tightrope

Most governments hate to devalue because in the short-run there are more losers from devaluation than there are gainers. The reason is simple. Imports and locally produced import substitutes become more expensive after devaluation and this affects the consumption basket of a large number of voters. On the other hand, exporters who benefit from devaluation are relatively few and the benefits of export-led income and employment growth come with a lag. So, why did the Governor of the State Bank of Pakistan devalue the rupee last week by 3.65 per cent?

Prudent exchange rate management is a delicate balancing act. Ours is a managed float, whereby the Governor of the State Bank sets the value of the rupee in view of the supply and demand for other currencies. In so doing, he weighs in the fact that the evidence on supply and demand is made murky by speculators. If he misreads the signals, and devalues excessively, the result is inflation and extra debt burden. If he over-values the currency, he risks out-pricing Pakistani exports and under-pricing imports, resulting in a trade deficit.

What should the Governor be guided by? The bazaar value of the rupee–dollar exchange rate and the FEBC premium are usually contaminated by speculation. More reliable guides are domestic and international inflation rates and the fiscal and trade deficits. Inflation in Pakistan, currently running at 13–14 per cent, is considerably higher than the trading partners' inflation of around 4 per cent. This suggests an appreciation of the real exchange rate, which requires a devaluation of the nominal exchange rate (real exchange rate is the nominal exchange rate times relative inflation; if the latter goes up, the nominal exchange rate has to be adjusted to maintain the value of the real exchange rate).

The other guide is the fiscal and the trade deficit, which together affect the current account in the balance of payments. A large current account deficit means that we

are spending more than we are earning. The fiscal deficit is unsustainable at over 4 per cent (post-budgetary shenanigans render the government's fiscal target for this year less credible) and the trade deficit has shot up to $3.5 billion. If these deficits were temporary, due to crop failure or other calamities, and if we had the reserves, we could have run those down to tide over the emergency. Alternatively, we could borrow short term in the international commercial capital market to cushion the economic shock. But if the problem is endemic and if reserves are already low, the international capital market demands a heavy premium, which increases the debt burden. In any case, such quick fixes are unlikely to get to the root cause of the problem, which is that as a nation we spend more than we earn.

What the Governor needs is a policy measure that reduces our expenditures and increases our earnings. Given the current macroeconomic picture, a sizeable devaluation of the currency is precisely such a policy measure. It sends a strong signal to domestic spenders that imports are expensive, so avoid them. Simultaneously, a message is sent to foreign consumers that Pakistani goods are cheaper, come and get them. This brings down the trade deficit and checks the pressure on reserves. Having arrived at this conclusion without any arm twisting, we may now approach the concessionary international lenders, i.e. the IMF and the World Bank, borrow at low rates and be rewarded for our wisdom!

It is often argued that neither Pakistani imports nor exports respond to price changes and therefore devaluation is an ineffective instrument. This is nonsense. In the aggregate, responsiveness to price signals is rational human behaviour. When imports become expensive, we postpone purchases and that reduces aggregate demand. Similarly, why should foreigners not buy more Pakistani goods when they become cheaper?

But let us ask ourselves what would happen if we did not devalue. An increasing number of people would take a position against the Pak rupee, confident that the value of the rupee cannot be sustained. This would put greater pressure on the rupee and the needed devaluation to correct the imbalance later would have to be much larger.

Another woolly argument is that we do not have 'exportable surpluses' and therefore exports do not increase when we devalue. This notion of exportable surpluses is a perplexing one. Does Lahore export knitwear because T-shirts are left over after the Lahoris have bought what they need? Does Sialkot export soccer balls because it has some to spare after meeting the needs of Sialkoti soccer players? Countries don't export because they have surpluses, but because they have a comparative advantage based on their abundant factor, which in our case is labour, raw cotton, and leather. If we price these factors correctly via the exchange rate, we will export, surplus or no surplus.

Finally, we must begin to address the fundamental problems faced by the economy to avoid devaluations, which may sometimes be necessary but are always disruptive. We must tame the impulses that result in fiscal deficits and address the perverse incentive structure that retards export-led growth. Otherwise, we shall find ourselves running frequently to the tailor to loosen our belts when the real culprit is obesity. Only by fighting obesity at both the aggregate and the individual level, will we achieve a stable and realistic exchange rate, which is the corner stone of sound macroeconomic management.

Source: Nabi, Ijaz, *The Friday Times*, Lahore, 19–25 September 1996.

Is there a case for devaluation?

The answer to this question is pretty straightforward. There is no evidence at all that the Pakistani rupee is over-valued and, therefore, there is little reason to believe that a devaluation is on the cards. Neither movements in the balance of payments and the capital account nor in the real exchange rate vis-à-vis our major trading partners and competitors suggest that the rupee is misaligned. Indeed, a devaluation, when none is called for, may actually retard our principal policy objective of reining in inflation.

First, the balance of payments. A sudden surge of imports or a sharp fall in exports or in factor payments registers as a balance of payments deficit. If it is not funded by movements on the capital account, reserves begin to be depleted. This shows that we want the rest of the world's goods and therefore its currencies more than the world wants ours. This is a clear signal that we must adjust downwards the value of our currency.

However, the evidence on recent movements in balance of payments does not show any sudden deterioration. The balance of trade is a negative $2.3 billion, which is in keeping with the medium-term trend. The services account is also in the negative at around $2.5 billion, again fairly close to the trend. Remittances, on the other hand, have registered an increase of around $500 million over the previous year. All of this adds up to a current account deficit of $2 billion, which is a little worse than last year's but is a substantial improvement over the year before that, when we went on a spending binge (the yellow cabs scheme).

A current account deficit is consistent with the fact that being a developing country, we are a net importer of capital. The capital account shows that direct foreign investment and concessionary official flows have financed most of the current account deficit—in fact, our reserves actually improved by $242 million in 1994–95 as a result of such transfers. All of this adds up to the conclusion that there is absolutely no untoward development in the balance of payments or in capital movements that calls for a devaluation of the rupee.

The second argument for devaluation is that, as a result of high inflation relative to our trading partners, the real exchange rate (which is simply the nominal exchange rate adjusted for the change in relative prices) has appreciated. This has raised the price of our exports and lowered the price of imports. This loss of international competitiveness, it is argued, must be remedied by a devaluation of the rupee.

Installation triggered

This is a sophisticated argument and requires a careful look at the evidence on movements in the nominal exchange rate and relative prices vis-à-vis our trading partners. I have done this for our five major partners, the US, Japan, Germany, UK, and

Table 1
Nominal effective exchange rate

	1980/1 (R0)	Sept. 1995 (R1)	(R1–R0)/ RoI	Trade weight	NEER
USA	9.91	31.55	2.2	35	111.4
France	2.11	6.46	2.1	8	24.5
Germany	4.92	22.29	3.5	19	86.1
UK	22.68	50.4	1.2	17	37.8
Japan	0.0463	0.32	5.9	21	145.1
Total					404.9

Table 2
Trade-weighted relative price index

	1980/1 (P0)	Sept. 1995 (P1)	(P1–P0)/ RoI	Trade weight	Trade-weighted consumer price index
USA	100	172	0.72	35	60.2
France	100	204	1.04	8	16.3
Germany	100	148	0.48	19	28.1
UK	100	218	1.18	17	37.1
Japan	100	125	0.25	21	26.3
Pakistan	100	323	2.23		
		Relative price index 167.95			
					242

France who together account for nearly half of our foreign trade (imports plus exports).

Table 1 gives the movement in the nominal effective exchange rate, or NEER, (which is simply an index of the nominal exchange rates of the five major trading partners weighted by their shares in trade) between 1980–81 and September 1995. The calculations show that NEER depreciated from 100 to 405. In other words, the same unit of major trading partners' currency now costs nearly four times as much as in 1980–81. This is a substantial nominal devaluation of the rupee. The question is: is it enough given that inflation in Pakistan is considerably higher than in the major trading partners?

To answer this, we have to look at how the relative prices have moved between Pakistan and the major trading partners. Table 2 traces the movement of prices in Pakistan and its five major trading partners. The last column of the table shows that the trade weighted consumer price index of our trading partners has increased from 100 to 168, while the index for Pakistan has increased from 100 to 323. It is this relative increase that exporters bemoan when they ask for a devaluation.

In other words, what the exporters want is a depreciation of the real effective exchange rate (REER), which is simply the relative price index (calculated in Table 2) divided by NEER (calculated in Table 1). Notice that NEER is 405 and the relative price index 241. Thus the depreciation in the nominal exchange rate has more than compensated for the higher price level in Pakistan relative to the major trading partners. In fact, there has been a substantial depreciation of the real effective exchange rate, so that Pakistani exports have become even more price competitive than in the past. Thus there is no justification at present for a devaluation of the nominal exchange rate to restore price competitiveness.

The recent adjustment of the Indian rupee is being cited as the third argument for devaluation. The evidence does not support this either. Between 1974 and 1975, India's CPI index increased from 100 to 488.5, while the nominal exchange rate index fell from 100 to 24.23. Meanwhile, Pakistan's CPI increased from 100 to 379 and the nominal exchange rate fell from 100 to 31.36. Thus the ratio of the two indices in the countries has moved fairly close together over the years and Pakistan has not suffered any loss of price competitiveness vis-à-vis India. India's exchange rate is now market determined and short run fluctuations in it do not call for an immediate response from us.

It is interesting that the market has read the evidence correctly and is not signalling a lack of confidence in the nominal value of the exchange rate. There is virtually no premium, other than the small margin to cover transaction costs, either in the curb market or the FEBC rate of exchange.

It is worth bearing in mind that exchange rate policy can influence only the nominal exchange and not the real exchange rate. The latter, which is the proper measure of competitiveness, is determined by relative price movements. Indeed, it may well be that a short term devaluation, when it is not called for, may buy a lot of long term inflation, resulting in an appreciation of the real exchange rate, thus producing results contrary to those intended.

Furthermore, a devaluation always has some short run costs such as an increase in the international debt burden and a general reduction in the standard of living. If there is a crisis in the balance of payments or a substantial appreciation of the real exchange rate, it might be worthwhile to bear the short run pain. But when such misalignments are not indicated, it seems unnecessary to add to the difficulties of the ordinary citizen already suffering under the ongoing structural adjustment.

Having said all this, we must recognize that exporters indeed are hurting. But the real culprit is high domestic inflation, which has raised the costs of production, including the high interest rates. To control inflation, our principal policy target must continue to be a reduction in the fiscal deficit. This is the best way to restore competitiveness in the long run to put the economy on the path of exported growth.

Source: Nabi, Ijaz, DAWN, *Economic and Business Review*, Karachi, 11–17 November 1995.

Appendix 9.3

Winner or Loser? A Post-Quota Case Study of Pakistan's Textiles and Clothing Exports

Umair Hafeez Ghori analyses the impact on Pakistan's Textiles and Clothing (T&C) sector after the quota regime came to an end. Excerpts from his detailed analysis follow.

Issues for consideration

A major weakness of Pakistan's T&C industry is the lack of diversity (both in terms of products and target markets). Since the end of quotas, growth was recorded only in selected textiles segments, while clothing exports declined significantly. The emphasis on cotton textiles is a major factor behind the lack of product diversity into the man-made fibre (MMF) and composite MMF-cotton categories. This especially affected Pakistan's exports to the EU/US in the wake of the economic slowdown.

Prior to the economic slowdown in the EU/US market, there were predictions that the looming crisis may affect Pakistani T&C exports. The main reason behind the need to diversify from heavy reliance on cotton-based products is that polyester and MMF products are considered more affordable than 100 per cent cotton products (that cost more and are difficult to maintain). Since the global financial crisis affected the average spending on clothing, consumers preferred the cheaper composite fibre products. This is further reinforced by statistics examined where growth is visible only in textiles related made-ups sector rather than value-added clothing industries.

Anis-ul-Haq (Deputy Secretary of the All Pakistan Textiles Mills Association–APTMA) admits this weakness and comments that: '. . . we are caught in the web of 80–20! 80 per cent of our exports go to 20 per cent of countries. Similarly our fabric composition is mainly 80 per cent cotton and 20 per cent synthetic fibre. Our export reliance versus domestic use is also in 80:20 ratio whereby we place 80 per cent reliance on export and rather than value addition. We suffer from structural imbalance and hence are not trained in value addition production'

According to Anis-ul-Haq, Pakistan's industry is handicapped because very few entrepreneurs venture out and search for alternative markets. Pakistani entrepreneurs mostly rely and plan on the basis of business information gleaned either through business magazines and informal networking rather than through trade offices abroad.

In addition to the typical Third World problems and supply side constraints such as power shortages, poor infrastructure, bureaucratic inefficiencies and political instability, Pakistan faces gradual obsolescence of its industrial infrastructure. The average performance of Pakistani T&C was not unexpected, given that exporters and industries were well aware of the risks and potentials of quota expiration. Most entrepreneurs invested in upgrading infrastructure and capacity building of workers through training programmes in order to enhance their productivity for the post-quota period challenges.

The value added industries have incurred the bulk of losses in the post-quota period in Pakistan. Awais Mazhar, owner of Angora Textiles (a vertically integrated unit specializing in knit garments, woven garments, and denim products that handled orders from high-end clothing brands) was one of the foremost casualties of the quota expiration process. According to Mazhar, a major cause behind Pakistan's decline in the value-added sector is low labour productivity along with extraneous factors such as the security situation, rising costs, energy constraints, and negative image of Pakistan as an outsourcing venue. Mazhar claims that he followed and acted upon 'all those analysis that over informed me when quotas were about to run out and the virtues of vertical integration'. Mazhar not only upgraded his manufacturing capacities by importing state-of-the-art equipment but also embarked upon an ambitious employee training regime.

Mazhar also provides unique insights of how the flawed investment policies of the Government of Pakistan affected the value-added industries, for example, in a bid to attract the global chemicals giant ICI into investing in the polyester subsector of Pakistan, the government offered ICI a 15 per cent tariff wall against any competing imports. As a result of this protection from competition, the polyester manufacturers in Pakistan often demand a price of their choice from the textile industries that combines traditional cotton yarn with MMF. The increase in cost is transferred from the textiles industries to the value added industries that are forced to source their inputs from local manufacturers because of high tariffs on textiles imports. These comments by Mazhar provide a link to Anis-ul-Haq's comments of Pakistan being 'caught in the web of 80–20' (as mentioned earlier).

The implication of these comments is that unless Pakistan reduces tariffs on textiles imports and MMF sectors, the input costs will continue to rise and will directly affect any value added sectors that are import-dependent. Unlike the MMF dependent clothing sector, bed linen, towels, and cotton denim fabric are not import dependent. This is the primary reason why these sectors have seen growth in the post-quota period and the value added industry has not.

Exports from Pakistan's value added industries were also affected by the yarn crisis of 2009–2010. This crisis sprang from high global yarn prices. Since Pakistani yarn is widely viewed as relatively cheaper in US dollar terms as compared to Indian and Chinese yarn, most yarn manufacturers exported their output rather than selling domestically causing yarn shortage for the clothing industries. The clothing industry pressured the Government of Pakistan to introduce a temporary 15 per cent export duty based on quotas in a bid to limit exports. However, this restriction was removed in July 2010 after the apex body of the textiles industry (APTMA) reported that 50 yarn-producing units had either shutdown or scaled down their operations.

In addition to the issues highlighted above, Pakistan's value added industry is significantly impaired by their inability to offer full-package service for foreign retailers. Syed Shad Mustafa (director of an intermediary company that sources local inputs for foreign clients) dispels the impression that only supply side constraints are to blame for Pakistan's performance in the value added segment. Mustafa cites extended power shortages in some cities of India, frequent natural disasters and civil disturbances

in Bangladesh and states that the decisive factor in modern clothing trade is the ability to follow the 'direct-to-store' service (the 'DTS Model'). Mustafa further elaborates that instead of being entirely dependent on reports by experts and business magazines to inform them of shifting market dynamics, Pakistani manufacturers following the DTS Model maintain overseas offices and warehouses. This allows them to gauge changes in fashion trends, and offer superior client service including reduced turnaround times for fashion-sensitive categories. If Mustafa's comments on DTS Model are contrasted with Awais Mazhar's experience, it may well explain why a vertically integrated processing unit that supplied leading foreign retailers went bankrupt. However, realistically speaking, the small- to medium-sized operator does not possess enough resources to maintain overseas offices. Therefore, the disparity between large operators and their business advantage over small- to medium-sized operators are likely to continue in the future.

Another factor affecting the performance of the Pakistan's T&C industry as a whole is preferential access. In the backdrop of the War on Terror, it was expected that the US would 'reward' Pakistan by concluding an FTA and reduce barriers to market entry (tariffs were as high as 29 per cent in some categories). The US retail industry backed Pakistan but there was heavy opposition by the US textiles industry groups. This opposition has continued to date and as a result no FTA with the US has materialized so far.

Pakistan's industry also needs to shift its focus on to other developed economies. Any FTA with the developed countries such as the EU, Canada or Japan would give Pakistan's T&C industry a competitive edge over its regional rivals. The need for an FTA with developed countries is further reinforced if the impending EU-India free trade agreement (FTA) is taken into consideration. Currently, Pakistan has an FTA arrangement with China which allows Pakistan to export textiles products to China while not extending preferential treatment to Chinese T&C imports into Pakistan. However, Trade Development Authority of Pakistan (TDAP) data shows that the only significant Pakistani T&C exports are raw cotton and cotton yarn. It is obvious that Pakistan's exports have less potential to succeed in China currently; therefore, exporters primarily concentrate on targeting US/EU markets.

While the T&C industry would definitely like to see FTAs with developed countries, the policymakers have cautious opinions about regional FTAs, especially liberalizing the currently impotent South Asian Free Trade Area (SAFTA) which excludes several T&C tariff lines from liberalization schedule. In this context, Omer Hameed of the TDAP states that the government is generally in favour of trade liberalization but certain sectors in the T&C industries voice strong opposition to it. Hameed forcefully argues in favour of trade liberalization and comments that 'our industries need to decide whether they want to stay in infancy of development or diversify and be competitive'. The opposition to sectoral liberalization usually comes from small- to medium-sized operators that are more numerous and exert significant pressure on the government. As a result, the Government of Pakistan is reluctant in opening up sensitive sectors such as T&C and agriculture. Policymakers are perhaps also mindful that they lack the resources to retrain, adjust, and compensate laid-off workers in wake of regional liberalization of the T&C sector. This fear preys most on the minds of the politicians that dictate trade policy rather than economists.

Since the larger T&C groups are aware of their competitive advantage, they see regional liberalization as opening up of an additional market. The small- to medium-sized enterprises, particularly the cottage industry-sized clothing units apprehend diversion of their orders to India if Pakistan's fabric manufacturers get a better rate as a result of tariff liberalization. These clothing units also fear that the influx of competing imports would affect their business in the local markets as well. Therefore, these sectors oppose regional trade liberalization in the Stolper-Samuelson sense.

The fears of the sectors are not unfounded. In a poor country with high inflation and unemployment rate, repercussion of mass lay-offs and decline in the leading industry is something that no policymaker can ignore. However, the myths and fears that have built in the minds of the small- to medium-sized operator against regional liberalization must be dispelled; for example, regional liberalization in the textiles sector would have meant that tariffs on fabrics and yarns would be considerably reduced, thereby enabling the clothing industries to use imported inputs. The recent yarn crisis in Pakistan could certainly have been avoided if the tariffs on yarn imports were lower!

The public choice theory also explains why Pakistan has not moved in the direction of regional liberalization, even where the government appears to acknowledge the positive effects this would carry for the Pakistani economy. The reality is that similar to developed countries, trade policy is dictated by the politicians that keep political, and not economic, considerations in mind. As a result, any measures that promote free competition with foreign imports are often looked at with hostility. Therefore, the Government of Pakistan must shoulder some blame for the mediocre performance of Pakistani T&C industries in the post-quota period.

Nevertheless, the recent positive steps taken by Government of Pakistan building on the Textile Vision 2005 scheme must be appreciated. The new Textile Policy for 2009-2014 scheme aims to enhance T&C exports to 25 billion USD by 2015. The policy extends PKR 42 billion in incentives during the fiscal year 2009-2010. Export refinance is reduced at a rate of 5 per cent with a PKR 2.5 billion allocation. PKR 5 billion is allocated as a relief on the existing long-term loans of the textile industry. Duty drawbacks are offered between 1 to 3 per cent for a period of two years for value added textile exports which will aid the industry to offset both its direct and indirect costs. Most importantly, this policy exempts the industry from regulated power supply (referred to as 'load shedding' in Pakistan) and allows it to have a prioritized gas supply. The new policy also establishes a Technology Upgradation Fund (TUF) that will contribute as a grant around 20 per cent of the capital cost on upgrade of T&C infrastructure.

Pakistan's T&C value added industries have yet to be weaned off their dependency on preferential access to the developed markets even after lapse of quotas, for example, Pakistan lobbied aggressively to secure preferential access to the EU market after 2005, having been unable to secure concessions under the EU GSP+ regime. More recently, these efforts culminated in the offer by EU to extend preferential treatment to Pakistan's T&C exports in October 2010 and also to assist the Pakistani recovery in the

aftermath of the severe flooding in the country. The October 2010 package of concessions featured three years of duty-free access for 75 per cent of tariff lines accounting for 27 per cent of Pakistan's exports to the EU (mainly in the textiles sector).

These concessions were later 'watered down' in November because of pressure from India and other EU members engaged in textiles production (namely, Italy, Portugal, Spain, and France). The revised package still kept the duty-free access for 75 tariff lines, but reduced the duty-free access period from three to two years, with a third year conditional on an assessment. Furthermore, the EU has incorporated quotas on sensitive categories (for example, fabrics, towels, women's jeans, and socks) which incorporate a suspension of duty-free access if imports grow by more than 20 per cent. For other products, a safeguard mechanism will serve as a safety net to protect against any major import surges. The EU package still has to secure official approval from the EU parliament and is further subject to waiver granted by the WTO. There is a strong likelihood that the waiver may face opposition from both the EU-based textiles manufacturing countries and other T&C exporters that compete against Pakistan in the EU T&C market. However, recently India dropped its opposition to the proposed EU package. In exchange, Pakistan has agreed to grant India most-favoured nation (MFN) status that it previously had not extended to Indian imports.

Pakistan's T&C industries are understandably desperate to enhance their competitive standing in the EU market. However, even when this concession package comes into force, it brings moderate benefits to the Pakistan's T&C industry (especially the value added segment comprising clothing products). Statistics examined in this research note have demonstrated that Pakistan's apparel exports have not experienced positive growth after 2005. Furthermore, availing this package would effectively mean that Pakistan's exports will be subjected to quotas and safeguards again which could artificially restrain the more profitable exporters of T&C in the country along similar lines in the Multi Fibre Arrangement/Agreement on Textiles and Clothing (MFA/ATC) period.

It is also interesting to note that Pakistan's bed linen exports to the EU, which already enjoys a significant share of the EU market, are being extended tariff concessions. The predictable positive effect of these EU concessions is that it will encourage more exports of bed linen to the EU. However, due to the proposed quota restrictions and the in-built quota growth rate coupled with safeguards to contain any spillover, the risk is that Pakistan may attract trade restrictions on its bed linen again (similar to the anti-dumping measures imposed by the EU on Pakistan's bed linen exports in 2004).

The EU concession package can also be criticized on the grounds that it does not encourage exports of labour-intensive clothing products. Instead, the package seems to buttress the already strong capital-intensive segments such as bed linen or other textiles made-ups. By designating some categories as sensitive, the flow of preferential treatment has been tightened considerably. With the EU concession package in the backdrop, it remains to be seen how Pakistan fares in the coming years. The current statistics show that Pakistan's T&C industry is now coming to terms with its strengths and weaknesses that were previously masked by the quota system. The liberalized trading environment has meant that competitive strengths of various T&C manufacturers will now determine trade performance more than preferential treatment or higher quotas in the developed markets.

Conclusions

Pakistan has the potential to excel in the post-ATC T&C trading environment but has so far managed lacklustre performance. Quotas skewed the manufacturing strengths of Pakistan and induced artificial diversification into manufacturing activities where there was little or no comparative advantage. The liberalized trading environment suits Pakistan in certain value added categories (which quotas had suppressed earlier). This is demonstrated by the superior performance in bed linen, cotton yarn, towels, and cotton denim fabric categories. Conversely, manufacturers that concentrated on categories purely due to availability of quotas have experienced declines However, with the possible signs of 'flying geese' type transmission of certain clothing industries from China, Pakistan may well be one of the recipients of the categories jettisoned by the Chinese clothing industries. This view receives further support from the fact that Pakistan possesses a large cotton base and some level of vertical integration in its T&C structure along with low labour costs.

From the 'flying geese' perspective, lack of liberalization will also mean that regional investment will be channelled towards more liberalized countries instead (such as ASEAN countries). Larger T&C segments in Pakistan are more willing to support market liberalization as compared to the small- and medium-sized entrepreneurs. The sensitive nature of the T&C industry has meant that the policymakers are reluctant to take any steps that may affect the smaller manufacturers. Pakistan also lacks the resources to compensate and re-adjust the industry segments that are inevitably affected by trade liberalization process. Hence the reluctance and lack of resources undermine the growth and diversification of Pakistan's T&C industries.

If a 'flying geese' type regional transmission does occur, Pakistan's falling clothing exports may receive a significant boost. In order to attract this investment, Pakistan's entrepreneurs have to overcome two major shortcomings. First, adopt measures to ensure availability of yarn for local clothing manufactures, and second, to increase productive capacities by adopting the DTS model of manufacturing. If the clothing industry signals its willingness to weather an increasingly competitive environment that follows liberalization, it may benefit from cheaper inputs which will allow this sector to become competitive again, especially when China is exhibiting signs of graduation to higher value added sectors. The challenge for Pakistan's value added industry is how it adapts to increase in competition that inevitably follows sectoral liberalization. To this, there is no easy answer. Currently, the Pakistani economy is characterized by high inflation rate, low employment, negative effects of the security situation and the floods. In these circumstances, the Government of Pakistan would be reluctant to risk any economic liberalization in the T&C sector, fearing adverse effects on its most vital industry.

Source: Ghori Umair Hafeez, 'Winner or Loser? A Post-Quota Case Study of Pakistan's Textiles and Clothing Exports', *South Asia Economic Journal*, vol. 13, no 1, 2012, 105–29.

Appendix 9.4

Globalization: Another Name for Imperialism?

Nigel Harris discusses the political economy of the nature of globalization and imperialism in our Age.

The charge of 'imperialism' has served the Left for a very long time as a supreme accusation against the political order of the world. The term implies not that strong states invariably try to bully weaker ones, nor that 'imperialism' is just a fancy name for Washington, but that there is a world political order embodying systemic relations of domination. However, while once there might have been relatively robust theoretical underpinnings to this approach (in Lenin's popularisation of the combination of Hobson and Hilferding), the thesis has long since been shown to be doubtful.

On the other hand, imperialism's opposite, 'national self-determination', seems equally of doubtful validity in conditions of economic globalization. Indeed, these theoretical difficulties become even sharper when it is recognized that Washington, the supposed global hegemon, is itself trapped in an apparently insoluble crisis in the global economic order—the political agenda comes apart from the economic. What follows are some notes for discussion on an alternative approach to characterising the world order.

(1) Since about 1980, the world economy and its constituent national parts, has been dominated by the transition to a single global economy, 'economic globalization'. This imposes on the world a changing pattern of territorial specialisation and interdependence, organized by global markets, not—as hitherto rightly or wrongly believed—by national states. The economic integration of the separate political territories (former 'national economies') into a single economic system has been achieved by states (at different times and stages) relinquishing control of external trade, of capital movement and finally, albeit partially, of labour. Indeed, by now it is doubtful in the core of the system whether 'national economies'—discrete territorial areas of autonomous economic activity, defined by political boundaries—any longer exist as objects of effective government policy. States here at best seek to manage global economic flows that begin and end beyond both their authority and even knowledge. The free flow of the global factors of production is creating a single integrated economy outside the control of any one national political authority (as in the original creation of national economies free movement within carved out a national economic entity from what had been often a regional economy—witness, for example, the formation of Germany or the partition of India). The destruction of the old Soviet Union and the former eastern bloc, of apartheid in South Africa, as well as the coming transformations of others (North Korea, Myanmar, Cuba, etc.) can be seen as only the more extreme examples of this apparently inexorable process of economic globalization.

(2) The first phase of the current transition has been characterised both by extraordinary levels of prosperity in the heartlands of the system (the Atlantic economy and Japan) and an unprecedented geographical spread of economic growth (to China, east and south-east Asia, eastern Europe to Latin America, and latterly to India). This in turn may now draw into the process sub-Saharan Africa. In the first phase, opinion rejoiced that apparently the world had mastered the secret of sustained and spreading economic growth; in the second, marred at the end by severe economic crisis in the heartlands, there were growing fears that globalization had robbed the world of political governance, the state, and imposed a global territorial division of labour which made it impossible to employ the mass of the labour force, implying long-term mass unemployment. There seemed to be simultaneously an existential political crisis of the state and an economic crisis of material survival.

(3) Historically, the current transition is the second great surge towards economic globalization. The first, between say—1870 and 1914—ended with two world wars and the Great Slump in which states not only clawed back powers they had conceded to global markets, but immensely enhanced and centralized political control over their respective national economies to an unprecedented degree, epitomised in the extraordinary concentration of state power in Nazi Germany and Soviet Russia. More generally, the period established an uncritical faith in the potential of state planning and dominant public sectors, nowhere more so than in Nehru's India. Everywhere governments mimicked the imperatives of the war economy, even in peacetime. It took nearly another half century after the end of the Second World War to resume the drive to economic globalizaton, now with much enhanced vigour and comprehensiveness, and encompassing the whole world, not just the Atlantic economy.

(4) Indeed, never before in the history of capitalism, it seems, has the ethic of competitive markets and 'neo-liberalism', penetrated so deeply into the domestic operations of the state, into virtually every cell of the social order. Neo-liberalism has established an extraordinary intellectual hegemony, founded not upon an excess of greed (that was always there), nor an intellectual error among economists, but rather as the ideological expression of an order of global capital—the neo-liberals are the product of the process, not its source. We are now within sight of the reversal of many of the major historical efforts to limit the power of markets—from the New Deal and Great Society legislation in the US (even including the right to collective bargaining) to the welfare state and social services in Europe. In the period from the 1950s to the present, there has been an almost complete reversal of the dominant statist narrative. In that time, in the developing countries, accelerated economic growth was seen as exclusively attainable through economic isolation, closure to the world; now it is seen as exclusively attainable through 'opening up'.

(5) 'Opening up' the national economy (and undertaking all the domestic reforms for this to work) involves allowing the integration of national and global economies, allowing domestic economic activity to be decided by global markets

rather than by the state—or electoral—priorities. By implication, the state relinquishes any ambition to shape the domestic economy in any particular direction, restricting itself to managing efficiently and facilitating the accommodation of global forces.

(6) However, the emergence of a national 'global state' (that is, a state, the function of which is to manage the local economy and society in conformity with global, not local, imperatives) profoundly weakens the political position of the State, compared to the past. The state is obliged to relinquish much of what used to be a national political agenda which involves the management of external trade, capital movements and, in principle, labour flows. It relinquishes power to bribe the electorate and to secure its political perpetuation, to reward patrons, etc. To put it, simplistically, it faces contradictory options—to secure economic growth (through integration in the world economy) but with weakened state control over its political environment; or to enhance its political dominance at home with economic stagnation. Of course, depending on specific circumstances of a particular state (and the cumulative effect of past policies), opening up to the world may not lead to economic growth, in which case, the state has no recourse except to rule by violence. In an existential crisis (such as, for example, faces the Assad regime in Syria), the state will be obliged to sacrifice present and future economic growth—and indeed, the inhabitants—to hold on to power.

(7) The threat to state power is political in a different way—through undermining the domestic social solidarity that is supposedly a precondition for stable government. No population is likely to remain indefinitely loyal to a state seen as working exclusively for foreigners (the 'world system'). Nowhere is this more apparent in developed countries than in the field of immigration. The mobility of labour internationally seems now to be a precondition for economic growth. No advanced economy is now self-sufficient in labour (including here the changing diversity of skills required to cope with changes in the economy imposed by changing global demand). However, the solidarity underpinning the old state required levels of xenophobia, and sometimes racism which are incompatible with continued immigration, required to sustain the 'churning' of the labour force to sustain economic growth (especially where there are high levels of native unemployment). Everywhere today, certainly in the heartlands, there are increasing restrictions on immigration and mobility, despite the damage this does to economic growth (not to speak of the welfare of an ageing native-born population). States are again caught in a contradiction—the conditions of growth undermine the elements of national closure (zero net migration) supposedly required to make state power secure (seen most vividly in North Korea and the old Stalinist states).

(8) It is perhaps this contradictory position which today inhibits states from copying the reactions to the interwar Great Depression which ended the first surge of globalization—economic closure and domestic authoritarianism. The reaction now is fragmentary and contradictory—moves to authoritarianism, along with continued neo-liberal reform, attempts to cut immigration, to demonise 'illegal immigrants' (and Muslims) but without systematic protectionism. Of course, the longer the crisis persists, the more it may become an existential issue for the state, especially if marked by popular revolt against economic austerity. Then greater the danger, states will seek to recover their lost powers, and reverse economic globalization, sacrificing the welfare of their own—and the world inhabitants—to their own political survival. The issue of a world slump was only settled last time around by resort to a world war and a terrible orgy of self-destruction. At the moment, world war seems unlikely but one should not underestimate the potential for auto-destruct when one or other state's existence appears threatened, producing the 'common ruin of the contending nations/classes'.

(9) These trends—if 'trends' they are—go with attempts to disenfranchise the citizenry, to isolate government from 'politics', to protect the global system (and states) from popular demands and pressures, and install technical or expert administration (the World Bank and International Monetary Fund (IMF) play a key role here in training a global cadre of experts to direct the financial administration of states). Independent central banks—and independent national statistical agencies—are required to reassure 'global investors' that mere governments—or 'politics'—cannot be allowed to interfere either with monetary policy or basic data. In the special case of Europe, experts have been parachuted to run Greece and Italy, and binding clauses inserted in respective constitutions to enshrine conditions of national management. Some of the language betrays the displacement of the sovereign people—'citizens' become 'clients' or customers for state services, where the criterion of judgment becomes efficiency and cost of provision not the exercise of popular sovereignty. Undermining popular representation further erodes the legitimacy of the state.

(10) In crisis, the limits imposed on national sovereignty by the new order are slowly becoming clearer. On the economic front, the global economic nexus and global market, severely discipline national policy, and those constraints are reinforced by the political order of states, the so called 'international community'. The state begins to behave as an agent for an economic and political world order, enforcing global imperatives on the domestic population, rather than representing it to the world at large (let alone defending it against external threats). If state sovereignty is no longer practicable, will the world's fascination with 'national liberation' be undermined? Not while aspirant ruling classes are willing to fight for a place at the top table and there are no alternative options for popular self-emancipation. Winning national independence and a new state allows privileged access to loot the new country—and then deposit the proceeds in Vermont or Kent or Provence (as with the Gaddafis or the Bhuttos).

(11) The conjuncture exposes the separation of what we might call two ruling classes: a territorial national ruling class, whose very existence depends on holding a national territory (composed of the state administration, armed forces and security services, crony capital, owners of land and infrastructure, etc), and a global ruling class which directs the companies and corporations which constitute the global economy, the mobile global rich, the staff of international agencies and non-governmental organizations (NGOs), etc. That is, a global social stratum for whom nationality is a

mere contingency, not a matter of defining identity and loyalty. In practice, the two classes are not at all clearly distinguishable, and members pass freely between the two. What is distinguishable is a political interest (for example, between neo-liberalism and economic nationalism), and a role (national versus international).

(12) Thus, we may be entering a period which combines both the extraordinary potential for an end of world poverty, and an existential crisis of the fractured political order of the world. The danger is that the territorial ruling classes may use their overwhelming control of the powers of physical coercion to restore national dominance of the global economy, resulting in domestic authoritarianism with economic stagnation (with possible perpetual warfare on the borderlands to enforce social discipline, a combination so brilliantly imagined in George Orwell's 1984). In practice—and hopefully—global economic integration is by now so advanced, it cannot be comprehensively reversed, even if components can be qualified (for example, free movement of labour), and states will continue to try to cheat on the rules. States have an interest in the developed countries, in inflating the popular fear that the new international division of labour will render redundant larger sections of the labour force, to support populist authoritarianism that could damage economic globalization—and hence global welfare. Elements of possible national capitalisms already might be seen to exist in the marriage between national militaries and crony capitalism in some important states (Russia, China, Pakistan, Iran, etc).

(13) As we have noted, many states have already been making adjustments to the new circumstances. One of the more curious—if not risible—by-products of this has been the ubiquitous spread of debates on what it is to be a native, the 'values' supposed to unite the natives, often under the pretext of the need to 'integrate' non-natives (immigrants, refugees, etc.). The discussion is obscure since what united, say, the British, was never shared values but common subordination to the British state. But it is embarrassing to admit that there is nothing else in common. As so often, out of its peculiar circumstances (including immense cultural diversity), Israel appears as a pioneer making these adjustments—combining militarized ethno-nationalism, religious orthodoxy, and authoritarianism, employing the Arab Israelis and Palestinians as an anvil on which to forge unity out of immigrant diversity, with perpetual war in the occupied territories as a source of popular fear. However, the combination in the medium term could be suicidal for an economy as globalized as that of Israel.

(14) Left to itself, the global system appears incapable of resisting self-destruction. Markets and the competitive drive to profit seem incapable of establishing the self-discipline to escape crash. The global capitalist class shows little potential for political self-government. For that, they are dependent on the existing political order. Yet the fragmented political order appears incapable of overcoming its ferocious rivalries to achieve unified action. The core problem, in sum, is an integrated world economy, driven by global markets (the outcome of which can neither be determined nor predicted) and which faces a fractured political order of competing states, each undermined by global capital. Capital for a very long period was able to hide behind one or other state but now in the final phases of the completion of a global bourgeois revolution, it is obliged to step into the limelight, unprotected by political power. Meanwhile, the opposition to global capital—from the scattered occupations, the Arab Spring, the trade union fight against austerity in Europe, to the hundreds of peasant agitations and strikes in China—remains trapped within each national context, each assuming a state which can change their environment for the better. The creativity of these movements is not in doubt, yet we cannot even begin to visualize a realistic road map to one world, a world without war, with a unified drive to end world poverty, secure a livelihood for all with security, in a safe and sustainable environment. Revolutions in one country can no longer achieve 'national liberation' (that requires breaking the global order), and though revolutions may spread (as we have seen in the Arab spring), the outcome only reiterates the same order of competing states, itself at the core of the underlying problem.

(15) These notes began with an implied criticism of the Left insofar as it identified the contemporary world as 'imperialist'. The charge put Washington at the centre of a world system of domination, implying that achieving self-determination by overthrowing Washington would achieve the liberation of the world. However, Washington itself is victim to a global capitalist order. Not only is it mired in an apparently insoluble economic crisis, it has lost its economy (and its capital, now global), now a junction in global flows. Its spectacular armaments in no way resolve the economic problem. Washington's extension into the world is not 'imperialism' but an attempt to create a substitute for the missing world government, not in the interests of the people of the world so much as the tiny minority that directs the US.

Source: Harris, Nigel, 'On Economic Globalization, Neo-liberalism and the Nature of the Period', *Economic & Political Weekly,* vol. xlvii no. 22, 2 June 2012, 28–32.

NOTES

1. All these numbers are from Ahmed, Viqar and Rashid Amjad, *The Management of Pakistan's Economy, 1947–82* (Karachi: Oxford University Press, 1984), 245.
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3. Ahmed, Viqar and Rashid Amjad, op. cit., 65.
4. Lewis, Stephen, op. cit., 1969, 59.
5. Ahmed, Viqar and Rashid Amjad, op. cit., 243.
6. Ibid. 243.
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9. Ibid. 358.
10. Lewis, Stephen, op. cit., 1969, 12.
11. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 244–5.
12. Institute of Developing Economies, *The Study on Japanese Cooperation in Industrial Policy for Developing Economies*, (Tokyo, 1994), 129.
13. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 74.
14. Ibid. 246.
15. Ibid. 246.
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17. Ibid. 75, emphasis added.
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19. Asian Development Bank, op. cit., 1985, 359.
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22. Ibid. 80.
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28. Ibid.
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31. Ibid. 250.
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73. Ahmed, Viqar and Rashid Amjad, op. cit., 1984, 93.
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Part 3

Fiscal Policy

The two chapters that constitute Part 3 of this book are devoted to issues of taxation and expenditure, debt and deficit (i.e. fiscal policy). We examine the tax structure as it existed in Pakistan up to around 2011, following which much changed, and examine the fiscal relationship between different tiers of government prior to that time. The tax-to-GDP ratio and the nature and structure of taxation in Pakistan are analysed in detail, since they form a fundamental part of the fiscal policy. Pakistan's perennial fiscal deficit, and hence the ever-increasing debt burden, is considered to be one of the most serious problems of the economy, affecting a number of other variables as well. We question the claim that the fiscal deficit causes most of the problems in the economy that are attributed to it. We find that while government expenditure in excess of revenue is a problem, the more conventional attributes of a fiscal deficit are found wanting in the case of Pakistan. Our analysis suggests that the issues of politics, governance, and quality of public expenditure should perhaps form the focus of informed debate about the fiscal deficit. After the 18th Amendment and 7th National Finance Commission Award in 2010, there have been fundamental changes in the manner that different tiers of government will function and deliver social services, and the way they will relate to each other. These issues are discussed further in the new, added, Part IV of this book.

10 Resource Mobilization and the Structure of Taxation

On 30 December 2009, in the presence of the Chief Ministers of the four provinces and the Prime Minister of Pakistan, the signing of the 7th National Finance Commission (NFC) Award by the members of the NFC, took place at Gwadar in Balochistan. Agreement on this Award was reached after six meetings of the NFC, and the Award came into force on 1 July 2010 for a period of five years as mandated by the Constitution of Pakistan. As a Report of the Institute of Public Policy states,

> it has been rightly acclaimed as a great achievement. It enhances significantly the share of the provinces in the federal divisible pool from 46.25 to 56 per cent in the first year and 57.5 per cent in the remaining years of the award. Punjab showed great accommodation by accepting multiple indicators for horizontal distribution, primarily for the benefit of the smaller provinces. It gave up its position that population should be the only criterion for allocating central government generated revenue.[1]

According to the Institute of Public Policy *Annual Report* for 2011, this was the first of two major 'hallmark developments'.

The second major event which reinforced the process of strengthening provincial autonomy, and has largely redefined the nature of fiscal policy—tax and expenditure—is the 18th Amendment to the Constitution of Pakistan, which became law on 9 April 2010. According to the Institute of Public Policy Report,

> with this Amendment the Concurrent List of the Constitution stands abolished, devolving the functions contained in this list largely to the provincial governments. This significantly enhances the range of functional responsibilities of provincial governments and constitutes an important step in bringing the government closer to the people.[2]

Not only does the 18th Amendment bring about changes in the structure of the government, it also radically redefines federal and provincial fiscal issues, and the relationship between the federation and provinces. The Institute of Public Policy maintains, that on account of these two developments, 'the years 2009–10 and 2010–11 will be memorable years in the history of Pakistan'.[3] Such is the nature and impact of these interventions—also see Chapter 13 for further details.

The consequences of such extensive transformations are discussed in different places in the Third Edition of this book, for they have an impact on taxation, expenditure, provincial autonomy, regional inequality, social sector delivery, and some other factors. Fiscal federalism and the implications and consequences are specifically discussed in Chapter 13, in Part IV. Chapter 10 examines issues pertaining to public policy and fiscal finances, and deals with issues prior to the 2010 changes which are still in a process of being established.

One of the major functions of government is to tax its people. This revenue is then supposed to be used for a number of purposes, which include the running of government itself, the provision of law and order, the defence of the country, and for infrastructure and social development. Governments build roads, schools, hospitals, and dams, and provide a host of other services. For all these purposes, governments raise revenue from those who make profit, from one source or another, within the country. Even though the role and extent of government involvement in the economy and in the lives of the people has been debated, with growing concerns that there may be 'too much government', and taxes, like death, are one of the two certainties that affect our lives.

Taxation structures and the extent of taxation vary from country to country, and often, governments within a country may suggest taxation reform based on their particular political dispensation. In Pakistan, a well-defined constitutional framework determines the nature of resource mobilization and the responsibilities of each of the different tiers of government, and has undergone change from time to time, but perhaps not as radically as after the 7th NFC Award and the 18th Amendment in 2010. This chapter discusses the structure, nature, and extent of taxation in Pakistan prior to these changes, focusing on the issues at each level of government. From the constitutionally ordained legislative functions of government to the relationship between different levels of government, and to the extent of revenue collected from different sources, this chapter examines the salient features of Pakistan's taxation structure. This chapter provides an historical account of how taxation and fiscal issues existed and were structured until 2011, and despite the changes which are still in a process of being implemented, there are numerous aspects of the old structure and system of public finance, which is still very pertinent to understanding how public policy works in Pakistan.

10.1 The Structure of Government and Taxation[4]

10.1.1 Legislative Functions

The Federation of Pakistan is governed by the Constitution of Pakistan of 1973 and all its amendments thereafter. The

Constitution specifies the functions of the federal government and of the provincial governments. The federal government has exclusive responsibility for undertaking functions under the Federal Legislative List, which is contained in the Fourth Schedule [Article 70(4)] of the 1973 Constitution.

The Federal Legislative List includes functions of a regulatory and service nature. Service functions include defence, external affairs, currency, stock exchanges, national highways, and strategic roads, railways, etc. (see Figure 10.1). In addition to these functions, which were the exclusive responsibility of the federal government, there was also a Concurrent Legislative List which contained functions which were performed by either the federal or provincial governments, or both. These service functions included population planning and social welfare, tourism, and education. Residual functions not specifically contained in either the Federal Legislative List or the Concurrent Legislative List were the responsibility, primarily, of the

<table>
<tr><th>Legislative responsibilities</th><th>Services</th><th>Actual allocations of functions</th></tr>
<tr><td>Federal government</td><td>Defence
External affairs and foreign aid
Post, telegraph, telephone, radio, and TV
Currency and foreign exchange
Institutes for research
Nuclear energy
Parts and aerodromes
Shipping, air service, railways, and national highways
Stock exchanges
Geographical and meteorological survey
Censuses
Mineral oil and natural gas
Industries</td><td rowspan="2">Federal government</td></tr>
<tr><td rowspan="2">Federal/provincial governments</td><td>Population planning
Electricity (except KESC)
Curriculum development, syllabus planning, and centres of excellence
Tourism</td></tr>
<tr><td>Social welfare and employment exchanges
Vocational/Technical training
Historical sites and monuments</td><td>Federal/ provincial governments</td></tr>
<tr><td>Provincial governments</td><td>Law and order, justice
Highways and urban transport
Agricultural extension and distribution of inputs
Irrigation and land reclamation
Secondary and higher education</td><td rowspan="2">Provincial governments</td></tr>
<tr><td rowspan="3">Local governments</td><td>Curative health
Land development
Primary education</td></tr>
<tr><td>Preventive health
Farm-to-market roads
Water supply, drainage, and sewerage</td><td>Provincial/local governments</td></tr>
<tr><td>Link roads
Intra-urban roads
Street lighting
Solid waste management
Firefighting
Parks, playgrounds</td><td>Local governments</td></tr>
</table>

Source: Hanif, Naveed, 'The Structure of Government in Pakistan', *News on Friday*, Karachi, 25 August 1996.

Figure 10.1
Legislative and Actual Allocation of Functions among Different Levels of Government in Pakistan Prior to 2010

provincial governments—functions such as agricultural extension, irrigation, justice, and police. While the specific roles and functions of the federal and provincial governments were part of the 1973 Constitution, *the existence of local governments was not a formal part of the Constitution*. The status of the District Governments after 2001, was also not formally part of the Constitution, although they were part of the Legal Framework Ordinance (LFO) and found temporary reprieve under the 17th Amendment to the Constitution. Although amendment 140A to the Constitution based on the Legal Framework Order of 2002 required provinces to establish and empower local governments, it did not recognize local government formally as the third tier of the State. This meant that under this new, partially protected, District Government System, local governments had no constitutional protection, and provinces still retained disproportionate power. (Article 140A stated: 'Each Province shall, by law, establish a local government system and devolve political, administrative and financial responsibility and authority to the elected representatives of the local governments'—LFO 2002). The elected government after 2008, eventually disbanded the 2001 District Government system, and as has been the pattern of elected governments—see Chapter 12—no elected local governments existed anywhere in Pakistan for some years, a state which continued to prevail well in to 2013. Many of the residual functions that were not part of either of the Legislative Lists, and which were supposed to be performed by the provincial governments, used to be delegated to the local governments by the promulgation of ordinances. The 1979 Local Government Ordinance, which defined and allocated the responsibility of local government, was operative in the Punjab, Sindh, and the NWFP, while the 1980 Ordinance applied to Balochistan until 2001, when the Local Government Ordinances of 2001 replaced the earlier ordinances. These ordinances defined the functions and roles of the local government as delegated to them by the provincial governments.[5]

Of the functions allocated to local government by the provincial governments, there were a set of *compulsory* functions that urban councils, in particular, were expected to perform, in addition to an *optional* set of functions, which, as the name suggests, may or may not be performed by the local governments.

Figure 10.1 presents the services and functions that each of the three tiers of government were *expected* to perform, and those which they *actually* did perform. As the diagram shows, the federal government's role was, and continued to be of a more macro nature, while the provincial and local governments performed the key role in the provision of basic social and physical services and infrastructure. Moreover, an important observation from the way the responsibilities of the three governments were structured was that the type and number of functions that could be performed was 'very exhaustive and provides potentially for a high degree of decentralization of functions to local governments even in the rural areas'.[6]

While the potential of the role of different, especially lower, tiers of government may have been extensive, Figure 10.1 shows that most of the functions which were on the Concurrent List, and hence were the functional responsibility of both the provincial and federal governments, were actually being performed by the federal government. Similarly, a large number of responsibilities that were technically in the jurisdiction of local governments, were being performed by the provincial governments. This was more marked in smaller cities and the rural areas. Hence, it seems that some of the responsibilities of the lower tiers of government were being undertaken by a higher tier: the federal government in the case of the provincial governments, and the provincial government in the case of the local governments. Whether it was the higher tier that infringed on the jurisdiction of the lower tier, or the lower tier's inability—in terms of limited financial resources and/or inadequate institutional capacity—to cope with its designated responsibilities that was the cause of the encroachment, will be discussed in subsequent sections of this chapter. Partially as a consequence of these problems, a new District Government System was designed and put into place by 2001.

Table 10.1
Direct and Indirect Taxes at Different Tiers of Government

	Direct taxes	Indirect taxes
Federal government	Income tax Corporation tax Wealth tax Property taxes	Sales tax Excise duty Import duty Exports duty Gas, petroleum surcharge Foreign travel tax
Provincial government	Land revenue Urban immovable property tax Tax on transfer of property Agriculture income tax Capital gains tax Tax on professions, trades, and callings	Stamp duty Motor vehicle tax Entertainment tax Excise duty Cotton fee Electricity duty

10.1.2 Inter-Governmental Fiscal Relations Prior to 2010[7]

Provincial and Local Governments

Before the implementation of the District Government System in 2001, local governments were extensions of provincial governments and the former acted on behalf of the latter. There was, therefore, a great deal of overlap between these tiers of government.

The provincial tax machinery used to collect some taxes which were then returned to the local councils. The Excise and Taxation Department and the Registrar of Stamp Duties, both of the provincial government, were responsible for collecting the local property tax and the tax on the transfer of property. The reasons given for this were as follows:

> The justifications generally offered for provincial collection (with revenue sharing) of municipal taxes are, first, that sophisticated procedures are involved in the assessment of liabilities of some taxes. These procedures are perhaps beyond the capabilities of local taxation departments, especially in the smaller jurisdictions. This is the justification given for assumption of the responsibility for property tax collection by the provincial governments. Second, that it is possible to realize significant economies of scale and/or avoid double taxation. This is the case particularly with a local tax which is levied on a similar tax base as a provincial tax. For example, the base for the tax on transfer of property is analogous to that for stamp duty and that for the local rate is identical to that for land revenue. As such, it is efficient for the provincial tax agency to collect both taxes at the same time and hand over the local component of revenue to the councils.[8]

In 1985/6, provincial governments, on behalf of local governments, had collected about 12 per cent of the total revenue receipts of urban local governments, and 5 per cent of the receipt of rural councils.[9]

There used to be a revenue-sharing arrangement between provincial and local governments which consisted mainly of the property tax and betterment tax, where a major portion of these taxes were transferred to the relevant local councils. In the case of the property tax, 85 per cent was returned to the local governments in the Punjab, Sindh, and Balochistan, while in the NWFP, as much as 95 per cent of total receipts of this head (net of collection costs) were made available to the local councils. It is important to point out that, while provincial governments received revenue from the federal government on the basis of population, the local governments received revenue on the basis of *collection*. Hence, there was no cross-subsidization and the larger the amount of revenue collected from a particular urban local council, the more it received, irrespective of its size. (There were no revenue-sharing arrangements between the provincial governments and local rural councils.)

Provincial governments used to have access to revenue-deficit grants from federal governments that bailed them out when they fell short of funds. Surprisingly, no such general grant-in-aid from provincial to local governments existed. The grants-in-aid from provincial government to local councils were specific in nature and used to finance recurring expenditure on education and health. Local governments had to take care of their recurring deficits themselves.

Moreover, local governments made further payments and transfers to provincial governments in the form of revenue from a surcharge on local taxes, especially in the NWFP and the Punjab. For example, an education cess of 12 per cent on octroi was charged in the NWFP, which was transferred totally to the provincial government. As an important and detailed report argued, 'this tendency of the provincial governments to ride on the back of the Local Government is a unique feature of the public finance structure of Pakistan'.[10]

Under the new system of 2001—now disbanded—as in the past, the districts continued to rely on federal transfers. In the earlier structure, octroi collected by urban councils constituted 50–60 per cent of autonomous local revenues, while zila export tax on agricultural goods out of rural councils (zila councils) collected about the same for these administrative units. These taxes were abolished in 1999–2000 before the District Government Plan was implemented and the arrangement was that the federal government would come up with a replacement grant paid out to the Tehsils. Under the new system, District Governments relied heavily on revenue transfers from the provinces and from funds marked for vertical programmes. In addition, similar to the National Finance Commission Award, which distributes funds from the federation to the provinces, a Provincial Finance Commission was also designed in each of the provinces, although they never came into being in any effective manner.

Federal and Provincial Governments

It is somewhat surprising that local governments had been expected to keep their revenues and resources in check and maintain a significant ability to self-finance their expenditures, while provincial governments were, for the most part, given a somewhat freer hand by the federal government. There existed an elaborate mechanism by which fiscal transfers from the federal to the provincial governments took place from taxes collected by the former. In fact, this mechanism was sanctified by the Constitution, where 'the Federal Government was required to transfer revenues from taxes, as may be specified from time to time, to the provincial governments. Taxes to be included in the divisible pool and the share to be given to each province is determined by various awards/commissions.'[11]—see Table 10.2.

The National Finance Commission (NFC) is a body constituted by the President of Pakistan which is meant to divide the revenue-sharing formula for the divisible pool of resources to be made available from the federal to the provincial governments. The NFC is supposed to announce an award every five years, on which basis the divisible pool is determined. However, as Table 10.3 shows, the NFC has not been constituted every five years and there was a gap of seventeen years between the 1991 award and the previous

Table 10.2
Share of Provinces in Federal Revenue Receipts

(Rs. m)

Classification	2010–11 Revised	2011–12 Budget
DIVISIBLE POOL TAXES		
Income Tax	337,304	407,924
Capital Value Tax	2,493	0
Sales Tax excl. GST	330,398	437,404
Federal Excise (Net of Gas)	69,122	85,977
Customs Duties (excl. EDS)	95,348	112,627
Royalty on Crude Oil	19,213	14,879
Royalty on Natural Gas	34,440	32,140
Gas Development Surcharge (GDS)	31,072	24,427
Excise Duty on Natural Gas	12,326	15,359
GST on Services*	65,985	72,583
Total:	**997,701**	**1,203,321**
PROVINCE-WISE SHARE		
Punjab	463,594	576,862
Sindh	277,878	324,409
Khyber Pakhtunkhwa**	156,921	191,847
Balochistan	99,307	110,204
Total:	**997,701**	**1,203,321**

* The indicative shares of GST on Services are strictly provisional at this stage. These shares would be revised and adjusted in the light of decision taken after discussions with the provinces.
** Inclusive 1% War on Terror

award of 1974. Attempts were made in 1979 and 1985 to form the NFC, but all such initiatives failed. The next award was to be made in June 1996, but was delayed by a few months and was finally announced by one of Pakistan's numerous unelected, so called caretaker governments in late 1996. However, numerous objections to the award were raised by members of parliament elected to the provincial and federal governments following the 1997 general elections (see Appendix 10.1)—also see Chapter 13 for the most recent NFC Award of 2010.

Table 10.3 shows how the composition and size of the divisible pool from the federal to the provincial governments has changed over time. After an increase in the number and the amount of taxes between 1951 and 1970, there was a contraction in both in 1974, reducing the size of the divisible pool. The NFC award of 1991 distributed 80 per cent of the revenues from the federal to the provincial governments in the case of income tax, export duty on cotton, excise duty on tobacco, and sales tax. 'In addition, the Federal Government took over the responsibility of financing any residual deficits of the provincial governments in their recurring budgets. These ad hoc subventions and grants have grown very rapidly in subsequent years.'[12] Hence, the provincial governments got a far better deal through this revenue-sharing arrangement in 1991 than ever before. This is most noticeable from the fact that the total revenue accruing to the four provincial governments more than doubled from Rs. 7.1 billion in 1990/1 to Rs. 15.9 billion the next year after the award in 1991/2. While provincial governments' tax revenue in these two years increased by 40 per cent, non-tax revenues increased by 370 per cent![13] The 1991 NFC award gave a much needed boost to provincial government finances, which ended up in surplus for a change, but in subsequent years, they again ran into the perennial problem of huge deficits (see Appendix 10.1 in the first edition of this book). See Chapter 13 on the 7th NFC Award and for more recent developments.

In the case of revenue transfers from provincial to local governments, it was revenue raised from each council that determined the amount transferred to the urban local councils. In case of the NFC award and transfers from the federal to the provincial governments, it used to be essentially a single factor, population, which determined which province would get what share from the divisible pool. Hence, cross-subsidization would take place from a province that provided a greater share to the exchequer, to a province that did not contribute as much, simply because it was to receive a certain amount based on its population share (see also Appendix 10.1).

Despite an elaborate mechanism of resource transfers from the federal to the provincial governments, provincial governments were very frequently in deficit. Whenever this happened, the federal government had given ad hoc subventions and grants. Moreover, the Annual Development Programmes of the provinces had also been financed, at times totally, by resources transferred from the federal to the provincial governments. Another important difference between provincial and local governments was that provincial governments had recourse to interest-bearing loans from the federal government, which local governments did not.

Under the 1997 NFC Award a number of inter-governmental transfers were available to the provincial governments, three of which were 'unconditional'. The first was revenue sharing on the basis of population which included revenue from a divisible pool of taxes that was shared on a 62.5/37.5 basis between the federal and provincial governments, where population share determined which province would get what—see Table 10.3. The population-based transfers formed the largest amount available under this 'unconditional' category. Then there were shares in the form of straight transfers, based on origin, and included revenue from royalty and development surcharges on gas, royalty on crude oil, and profits from hydroelectric projects. Finally, special grants were made to Balochistan and the NWFP as these were considered to be less developed than either the Punjab or Sindh. Apart from these three unconditional sources of revenue given from the federation to the provinces, there were numerous 'conditional' grants, many of which were based on a matching basis—see Box 10.1 for an evaluation of the intergovernmental transfer system.[14] However, as Chapter 13 shows, 7th NFC Award of 2009 was a major departure from past practices, and brings about substantial changes from previous NFC Awards.

Table 10.3
Revenue-Sharing Arrangements under Various NFC Awards

Divisible Pool	Raisman 1951	NFC 1961–1962	NFC 1964	NFC 1970	NFC 1974	NFC 1990	NFC 1997
A. Income tax & Corporation Tax	50	50	65	80	80	80	37.5
B. Other Direct Taxes							37.5
C. Sales Duty	50	60	65	80	80	80	37.5
D. Excise Duty							37.5
– Tea	50	60	65	80	–	–	
– Tobacco	50	60	65	80	–	80	
– Sugar	–	–	–	–	–	80	
– Betelnut	50	60	65	80	–	–	
E. Export duties							37.5
– Cotton	–	100	65	80	80	80	
– Jute	62.5	100	65	80	–	–	
F. Import Duties							37.5
G. Estate/ Succession Duties	–	100	–	100	–	–	37.5
H. Capital Value Tax on Immovable Properties	–	100	–	100	–	–	37.5
I. Petroleum Sugar cane							100
J. Gas Development Surcharge							100
Total							
Div. Pool Transfers as % of Fed. Tax Revenue	12.8	23.1	27	33.4	29.8	35.3	37.3

Assigned shares to provinces under NFC Awards (percentages)

Province	Raisman 1951	NFC 1970	NFC 1974	NFC 1990	NFC 1997
Punjab	59 (64)	57 (62)	60 (60)	58 (58)	58 (58)
Sindh	24 (20)	23 (22)	23 (23)	23 (23)	23 (23)
NWFP	15 (14)	16 (14)	13 (13)	14 (14)	14 (14)
Balochistan	2 (2)	4 (2)	4 (4)	5 (5)	5 (5)
Total	100	100	100	100	100

Source: Ahmad, Nuzhat and Syed Ashraf Wasti, 'Pakistan', in Smoke, Paul, and Yun-Hwan Kim (eds.) *Intergovernmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future* (Manila: Asian Development Bank, December 2002).

Box 10.1

Overall Evaluation of the Intergovernmental Transfer System Prior to 2010

The intergovernmental transfer arrangements in Pakistan, which include shared taxes based on population, straight transfers based on collection origin and various grants, have been criticized by experts for several reasons. The straight transfers component (12 per cent of total transfer revenues) returns selected resource revenues (oil, gas excises and royalties, and hydroelectric profits) to the point of collection. These arrangements are criticized for having no particular economic justification. On the other hand, they do benefit the smaller and less wealthy provinces, but this creates some major resentment. Larger, wealthy provinces are now seeking similar resource treatment for their agricultural commodities. Some argue that revenues from straight transfers would be better utilized for equalization if they were a part of a federal general revenue pool used for financing fiscal equalization if they were a part of a federal general revenue pool used for financing fiscal equalization transfers to the provinces. However, given the distribution of natural resources and the current political environment, it may be advisable to continue with the present system of straight transfers as they provide some resources to backward provinces.

The flow of funds through tax revenue-sharing arrangements (62 per cent of total transfer funds) is done on the basis of population. This programme is to be commended for its simplicity and objectivity in transferring a large pool of resources in a predictable fashion to bridge vertical fiscal imbalances. Moreover, Shah (1997) points out that these transfers are equalizing with respect to own tax collections and also mildly redistributive with respect to provincial GDP. The programme, however, does promote excessive dependence of provincial governments on federal transfers, which reduces own-source revenue collection incentives and encourages weak tax administration. As a consequence, the provincial tax bases are far from fully exploited, and further tax decentralization remains an unexplored option.

Traditionally very little attention has been given in Pakistan to fiscal capacity in addressing regional equity issues. The transfers system has lacked an explicit equalization standard against which achievements can be evaluated. Adoption of a formal fiscal capacity equalization programme and allocation among provinces by an appropriate predetermined formula would set a specific standard of equalization to be achieved. This would also help to determine the total amounts of transfers in advance, facilitating the planning of expenditures. The approach adopted by the NFC prior to the 1997 Award was purely one of gap filling where the deficits in the provincial budgets were being met. There were also no incentives in the system to reward greater revenue effort or efficiency in expenditure management.

The NFC of 1997 introduced a matching grant system. Under this system, an additional matching grant, which is equal to additional revenue mobilized from taxation reforms involving rate increases, removal of exemptions or introduction of new taxes, is given to the provinces. There are two contrasting views on the impact of this reform. One view is that for the first time, emphasis has been placed on incentives for better resource mobilization and an explicit premium is placed on the level of fiscal effort in the revenue sharing formula. The closed-ended nature of the programme is also seen as limiting potential abuses. If considerable improvements in revenues were seen, proponents argue that the matching grants system could be expanded to include all revenues in its net.

The contrasting view is that the programme of matching transfers for resource mobilization is not well conceived. It rewards provinces for higher tax effort due to changes in structure and rates of taxation but provides no incentives for revenue increases due to improvements in tax collection and administration. The programme also shows a lack of concern with additional burden of taxation at a time of deteriorating quality and quantity of provincial public services. The services provided by the provinces have been deteriorating over time, and additional taxation from the provinces without an accompanying increase in quality of provision may not be acceptable to the taxpayers. To be successful, rewarding general fiscal efforts as opposed to the present, more limited approach may prove to be more powerful in raising provincial revenues.

Federal-provincial specific purpose transfers in Pakistan are generally ad hoc and discretionary, and they primarily meet political rather than economic objectives. Certain transfers are intended to compensate the two fiscally disadvantaged provinces for their weak fiscal capacities but higher expenditure needs. In the absence of significant tax decentralization and a formal equalization programme, these represent a pragmatic approach to dealing with expenditure need differentials. As discussed later in our recommendations, however, a distribution formula based on indicators of backwardness would be more appropriate for distributing funds to these provinces.

The deliberations of a newly constituted National Finance Commission (NFC) have commenced and the respective positions of the federation and the federation units regarding future intergovernmental revenue-sharing arrangements have become clear. The research team interviewed various representatives of the Ministry of Finance, the provincial governments of the Punjab, Sindh, Balochistan, and NWFP, experts on public finance and media personnel. Various articles in the newspapers on the 1997 NFC Award were also consulted. First, it appears that there is a lack of federal willingness to further share tax revenues with the provinces. This stems from the current state of federal finances, with a high and rising budget deficit. The federal government has the primary responsibility for controlling the national budgetary deficit and retiring and servicing the activities in the country. Second, there exists in federal circles a perception of profligacy in expenditures and lack of own revenue generation at the provincial level, further dampening interest in providing additional resources. The federal government needs to resolve these problems by creating proper incentives for the provinces to behave as a responsible tier of government, rather than taking punitive actions, such as a substantial cut in revenue-sharing transfers.

The perspectives of the various provinces generally reflect their intent in increasing the share of resources that they receive. Sindh, for example, which accounts for 70 per cent of the revenue from all taxes, advocates a greater weight for origin of collection in the transfer of resources. Punjab is pushing for instituting royalties on their important commodities (wheat, rice, and cotton), arguing that these, like oil, are natural resources and should be treated as such. Balochistan, being the largest province, would like to see a distribution formula that places considerable emphasis on area. The NWFP is concerned that it is not receiving its electricity royalty as provided for in the Constitution. One point of agreement among the provinces was that the federal government has been paying little attention to the provincial concerns, and more needs to be done to meet their demands. There seemed to have been little room for negotiations in the past. The recent decision to constitute Provincial Finance Commissions is considered a step in the right direction. In the present environment and period of resource scarcity, however, there is concern that designing a system that is acceptable to all of the major players may be difficult.

Source: Ahmad, Nuzhat and Syed Ashraf Wasti, 'Pakistan', in Smoke, Paul and Yun-Hwan Kim, (eds.), *Intergovernmental Fiscal Transfers in Asia: Current Practice and Challenges for the Future* (Manila: Asian Development Bank, December 2002), 207–13.

10.2 The Structure of Taxation

The 1973 Constitution outlined the taxes and duties that the federal government was required to collect based on the Federal Legislative List prior to the 18th Amendment. These were as follows:

> Duties of customs, including export duties; duties of excise, including duties on salt, but not including duties on alcoholic liquors, opium, and other narcotics; duties in respect of succession to property; estate duty in respect of property; taxes on income other than agricultural income; taxes on corporations; taxes on the sales and purchases of goods imported, exported, produced, manufactured, or consumed; taxes on the capital value of the assets, not including taxes on capital gains on immovable property; taxes on mineral oil, natural gas, and minerals for use in generation of nuclear energy; taxes and duties on the production capacity of any plant, machinery, undertaking, establishment, or installation in lieu of any one or more of them; terminal taxes on goods or passengers carried by railway, sea, or air; taxes on their fares and freights; and fees in respect of any of the matters enumerated in the Fourth Schedule, but not including fees taken in any court.[15]

The provincial governments had the powers to make laws with respect to any matter other than those reserved for the federal government as described above. Just as the provincial governments had delegated some of their legislative functions to local government, they had also allowed local governments to collect some taxes that the provincial government did not itself collect. Hence, the provincial governments collected taxes that the federal government did not collect, and the local governments collected the residual taxes that the provincial governments did not collect. The distinction between direct and indirect taxes is also important, as discussed later. Table 10.1 gives a breakdown of the two types of taxes at the provincial and federal level prior to the 18th Amendment.

The revenue sources, based on rates and taxes that the provincial governments collected, included the following: tax on agricultural income; water rate; tax on trade professions, callings, and employment; capital gains tax on immovable property; excise duties on alcoholic liquor, opium, and other narcotics; tax on immovable property; land revenue; motor vehicle tax; stamp duties; electricity duties; entertainment duty; tolls on roads and bridges; betterment tax; taxes on cinemas and hotels; arms licence fee; court fee; cotton fee; and various other fees and taxes.

The provincial governments did not have the authority to assess and collect the entertainment duty or the urban immovable property tax in the Cantonment Areas in the provinces. Nevertheless, the collecting and assessing authority in these areas, the Cantonment Board, did collect and pass on a certain percentage of this tax to the provincial governments.

Almost all the major taxes worth any real revenue potential according to the 1973 Constitution, were with the federal government, and after the 18th Amendment, there has been a change in this mechanism. The Agricultural Income Tax (which is largely ineffective, though), Urban Immovable Property Tax, the Motor Vehicle Tax and Stamp Duties were the only exceptions. The revenue heads—see Table 10.2—assigned to the new order of local governments after 2001, were unable to generate sufficient revenue to meet local government expenditure needs. As a consequence, local government—District Government—continue to rely heavily on revenue transfers from provinces, and on direct, earmarked transfers from vertical programmes.[16]

However, it must be remembered that, since the existence of local governments was not constitutionally ordained or protected, their position was always somewhat tenuous. This was also reflected in the nature of fiscal powers that provincial governments had granted local governments. A report highlights that 'although separate fiscal powers have been specified for local councils, the provincial government has the overriding power to direct any local council within the province either to levy any tax or to increase or reduce any such tax by the specified extent or to suspend or abolish the levy of any such tax'.[17]

Understanding Pakistan's Taxation Structure

This section summarizes some of the key issues and components of Pakistan's revenue and taxations system and structure, primarily of the federal government, given its dominance in the taxation structure.[18] Also see Box 10.2 and Appendix 10.2 which look at similar issues.

The revenue receipts of the federal government constitute tax revenue receipts and non-tax revenue receipts. The revenue receipts of the federal government are derived from the following sources: i) proceeds from taxation; ii) net revenue of the Commercial Departments; iii) interest on loans advanced by the federal government; iv) return on investments made by the federal government; v) fees and other receipts realized by administrative ministries and divisions of the federal government; vi) surcharges on petroleum and natural gas, and vii) dividends.

Tax revenue collected by the Federal Board of Revenue (FBR) comprises of inland revenue and customs. Inland revenue comprise of income tax, sales tax, and federal excise duty. Tax revenue is of two types, direct and indirect, where direct taxes comprise income tax, workers' welfare tax, workers' participation fund and capital value tax. The indirect taxes are comprised customs, sales tax, federal excise, surcharge on gas, petroleum levy, taxes collected by the Islamabad Capital Territory (ICT) administration and airport tax. The major part of the revenue is administered by the Federal Board of Revenue. The non-tax revenue of the federal government is administered by various ministries/divisions and comprises the following sources: i) income from property and enterprise; ii) receipts from civil administration and other functions; and iii) miscellaneous receipts. In recent years, the largest component of non-tax revenue has usually

Box 10.2

Tax Evasion in Pakistan

One reason why Pakistan continues to have a low tax-to-GDP ratio, is the 'massive' tax evasion which takes place. Here are some accounts of the scale and estimates of this tax evasion.

1. Tax evasion hit 79 per cent, FBR admits
   Mubarak Zeb Khan, *Dawn*, Karachi 7 June 2011 reported:

The Federal Board of Revenue admitted on Monday that tax evasion hit 79 per cent this year and said it would have to be reduced to achieve the revenue target set for 2011–12. The tax gap (tax evasion) is the difference between potential and actual tax collection. The potential is the amount of tax the government will collect if everyone fully complies with the tax law. Briefing reporters on new taxation measures taken in the budget, FBR Chairman Salman Siddique, however, said there was no increase in the tax gap over the past few years.

According to a World Bank study, the tax gap, which was 69 per cent in 2008, has now gone up to 79 per cent. But Mr Siddique said as the figure of 69 per cent was calculated by using a different methodology, the two figures were not comparable. However, he conceded that 79 per cent was the highest-ever figure. At the same time, he said, the tax-to-GDP ratio also fell to 9.1 per cent from last year's 9.2 per cent. He projected the next year's figure at 9.5 per cent.

Mr Siddique said the FBR was focusing on reducing the tax gap. 'There is a potential to reduce the evasion percentage to 40 to 50 per cent.' The FBR chief said it was not possible to reduce the tax gap to zero. This was not even possible in developed countries like the USA (tax gap 22 per cent) and Britain (8 per cent). The tax gap in Pakistan could be brought down with constant efforts, he added.

A 2008 study showed that the gap in direct tax was 143 per cent, which was much higher than the 36 per cent gap in indirect taxes. This shows that a large number of people are not paying income tax.

Mr Siddique said there were nine such sectors (withholding agents), but they were not paying proper taxes collected from the taxpayers. 'We have full support of the top leadership, including the president and the prime minister, for broadening the tax base and bringing evaders and non-taxpayers under the net,' he said. In reply to a question, he admitted that there was a huge gap between the tax collection and its potential and said that efforts would be made to bridge the gap by improving the performance of FBR.

2. Shahnawaz Akhter, *The News*, Karachi, 19 February 2012

The International Monetary Fund (IMF) has projected a shortfall of Rs. 29 billion in revenue collection by the Federal Board of Revenue (FBR) against the target of Rs. 1,952 billion for fiscal year 2011–12 (FY12). According to baseline projections of the IMF, the FBR collection would stay around Rs. 1,923 billion. After any further improvement in tax collection, the tally may settle at Rs. 1,934 billion for the current fiscal year, the IMF said in a report released recently. In the last fiscal year, the FBR missed the target of Rs. 1,588 billion and collected Rs. 1,558 billion, showing a deficit of Rs. 30 billion.

The IMF projection of tax-to-GDP (gross domestic product) ratio is also behind the government target of 9.3 per cent. The tax-to-GDP ratio is estimated at 9.2 per cent for the current fiscal year, which was 8.9 per cent in the last fiscal year. The international agency attributed low tax revenue to weak fiscal structure, which resulted in a poor tax-to-GDP ratio, which is one of the lowest in the world. 'There is a general unwillingness to pay taxes, due to poor public service delivery and because of perceived unfairness in the tax system,' the IMF said. It said that agriculture is mostly outside the tax net; besides the number of taxpayer filing income tax returns is very small—about one per cent of the population.

Against dismal revenue collection, the IMF report said that there are large demands for government spending. 'Most notably, subsidies (mostly electricity subsidies) and interest payments consume almost half of government revenue while security spending uses up another quarter,' it added. As a result, there are large budget deficits that are difficult to finance, especially when foreign assistance is limited. Therefore, budgetary management relies too much on the containment of investment spending and borrowing from the banking system, the report said.

For a sustainable reduction in deficit, the IMF stressed upon a consistent growth in tax revenue collection. Besides, IMF suggested another attempt should be made at implementing the reformed general sales tax (GST), which can generate revenue up to three per cent of GDP in additional revenue.

3. Mubarak Zeb Khan, *Dawn*, Karachi, 16 March 2011

If official figures are to be believed, out of Pakistan's 1.7 million taxpayers, around 1.6 million taxpayers pay about Rs. 21,000 each as income tax every year. All of these people fall into the lowest tax bracket where their annual income tax is less than Rs. 500,000.

Even more interesting is the fact that this particular tax bracket has not gained many new entrants over the past three years; to be exact, statistics show that 1.663 million taxpayers paid less than Rs. 500,000 as income tax in 2008. This number went down to 1.478 million in 2009 and then back to 1.662 million in the tax year 2010. Clearly, over the past three years not many new taxpayers have stood up and been counted by the FBR.

This is not the only staggering statistic compiled by the Federal Board of Revenue; less than 20,000 people in Pakistan earned enough to pay between Rs. 1 million and Rs. 5 million (10 to 50 lakhs) as their annual income tax in 2010, while 21,077 taxpayers have paid annual income tax in the range of Rs. 0.5 million to Rs. 1 million (five to 10 lakhs) and earned the state exchequer a little over Rs. 13.5 billion.

This means that each of these 21,077 people paid an annual income tax of around Rs. 650,000. And this was

the income tax bracket with the second highest number of taxpayers. No wonder Pakistan is known for its low compliance level to income tax rules and international donors want the country to widen its tax base before asking the rest of the world for more aid and help.

Only 7,680 taxpayers earned enough to pay income tax in the range of Rs. 1 million to Rs. 1.5 million (10 to 15 lakhs). With a total collection of over Rs. 8 billion, each of these taxpayers contributed a mere Rs. 1.52 million to the government exchequer in the year. Around 3,000 taxpayers paid income tax between Rs. 1.5 million and Rs. 2 million (15 to 20 lakhs) a year while 2,414 taxpayers paid tax in the range of Rs. 2 million to Rs. 2.5 million (20 to 25 lakhs). For the next tax bracket, the number of taxpayers dropped steeply. Only 1,526 people paid tax in the range of Rs. 2.5 million to Rs. 3 million (25 to 30 lakhs) followed by 838 taxpayers who paid Rs. 3.5 million to Rs. 4 million (35 to 40 lakhs) as annual tax in 2010.

The number reduces to a mere 602 when it comes to people who paid more than Rs. 4 million to Rs. 4.5 million (40 to 45 lakhs) as annual tax. And only 526 taxpayers paid up to Rs. 5 million (50 lakhs). Each of them contributed Rs. 4.5 million (45 lakhs) to the government; this is less than the amount that one would need to purchase a Prado Land Cruiser. Also, there are only 4,426 taxpayers across Pakistan who declared income tax to be more than Rs. 5 million. However, FBR officials point out that this bracket includes corporate and other businesses.

Although the number of these taxpayers was low, their contribution in the total income collection stood at Rs. 286.023 billion during 2010 out of the total collection of Rs. 373.685 billion from 1,706 taxpayers. In other words, income tax collection from Pakistan's 1.6 million taxpayers remained Rs. 87.662 billion.

4. Shahbaz Rana, *Express Tribune*, Karachi, 24 February 2011

For every Rs. 100 collected by the Federal Board of Revenue in taxes, it misses another Rs. 79 due to tax evasion, said Salman Siddiqui, chairman of the FBR, while testifying before the Senate Committee on Finance and Revenue on Wednesday. The FBR estimates that the total revenue lost by the government as a result of tax evasion comes out to Rs. 1.27 trillion for the fiscal year ending 30 June 2011. This number is higher than the World Bank's most recent estimate of Rs. 796 billion and is equal to 8 per cent of the GDP, nearly equal to the worst case scenario for the projected fiscal deficit for the current year.

With numbers as astounding as this, a wide-ranging crackdown against tax evaders seems to be on the cards. The FBR detailed its plan to begin prosecuting evasion. 'The FBR has credible evidence against 708,600 tax evaders and a campaign against them will start from Friday', said Siddiqui. The number represents people who have taxpayer identification numbers, known as NTNs, but have not filed their tax returns. According to the plan, the FBR will give tax evaders a 30 day deadline to submit the details of their income and spending. If the evaders do not submit declarations voluntarily, tax authorities will issue a provisional tax notice with a two-month deadline to respond, following which the recovery effort will start.

The FBR plans to prosecute tax evaders using indirect estimates of their income and lifestyle. The ownership of movable and immovable property, foreign visits, and accounts in foreign banks will be used as evidence against suspected tax evaders. Siddiqui, however, was somewhat cautious about an aggressive campaign against tax evaders, fearing a negative impact on the economy. According to the FBR, over 70 per cent of all taxes evaded are corporate income taxes.

The Securities and Exchanges Commission of Pakistan has registered over 59,000 companies but only a little over 20,000 file their income tax returns with the FBR. The Senate committee's response suggested a degree of scepticism about the ability of the FBR to conduct an effective crackdown against tax evasion. 'My fear is that when the recovery campaign will be at its peak, the chairman of the FBR and his team will be transferred and that will be fault of the politicians,' said Senator Haroon Akhtar of the Pakistan Muslim League-Quaid. Other senators went even further, suggesting complicity between FBR officials and tax evaders. 'Tax evasion is not possible without the connivance of the FBR and the bleak scenario reflects that its efficiency is zero,' said Senator Ahmed Ali of the Muttahida Qaumi Movement, the chairman of the committee.

Siddiqui acknowledged that corruption within the department was a problem and pointed out that until some of the senior members of his team were not removed from their posts, the FBR would not be able to effectively prosecute evaders. He was also candid about the FBR's inability to meet its revenue targets for the current fiscal year, describing the collection of Rs. 1,667 billion as 'out of the question.' He put the more realistic figure at Rs. 1,586 billion, without any new measures to increase revenues.

5. Shahbaz Rana, *Express Tribune*, Karachi, 3 March 2011

The government is reluctant to give tax authorities the green signal to crack down on 700,000 tax evaders, even at a time when there is a shortfall in revenue collection. The February tax collection target was missed by a margin of Rs. 27 billion mainly because of a 10 per cent drop in direct tax collection, according to provisional statistics released by the Federal Board of Revenue (FBR). FBR managed to collect Rs. 103.1 billion in taxes against the target of Rs. 130 billion.

The shortfall is almost equivalent to what the government wants to collect by promulgating a new ordinance. The government is considering levying flood surcharge and doubling special excise duty rate in the ordinance to boost tax collection. Total tax collection in the first eight months of the current financial year (July–February) stood at Rs. 873.2 billion, a shortfall of Rs. 34 billion. Hence, the tax authorities are now facing an uphill task to collect Rs. 757 billion in the remaining four months. The FBR needs to collect an average Rs. 189.3 billion per month to achieve the target, which is 'over-ambitious' according to a former FBR chairman. FBR Chairman Salman Siddique said his goal 'is to achieve the year-end target of Rs. 1.63 trillion by all means.'

Statistics show that from the Rs. 873 billion collection, direct taxes were Rs. 309.4 billion, which is just 35.4 per cent of the total collection. A member of FBR said that the shortfall in income tax collection was Rs. 16 billion, indicating that something was wrong with the audit and income tax wings of FBR. The international community has largely stopped loan disbursements due to the government's inability to implement reforms. The budgetary support by the international community dropped to a mere Rs. 17.9 billion, shows the finance ministry's fiscal operation summary. The revenue shortfall compels the authorities to borrow from the central bank to finance the budget deficit that further fuels inflation.

On 23 February in a meeting of the Senate Standing Committee on Finance, the FBR chairman said that tax evasions amounted to 79 per cent of total taxes in the country. FBR had credible evidences against 708,600 tax evaders and would launch a campaign to net the evaders from 25 February, he added. Only 1.9 million people submit income tax statements out of the registered 2.9 million national tax number holders, a gap of one million.

The plan

'Everything from newspaper advertisements to provisional tax demands against the evaders is ready, but we are waiting for the green signal from the higher authorities,' says the FBR official. The FBR's plan requires approval of the Economic Coordination Committee (ECC) of the cabinet. ECC did not take up the issue of approving a framework to broaden the tax net in the meeting held on Tuesday. The authorities have chalked out a plan to collect at least Rs. 5 billion from the tax evaders during April to June this year. According to details, FBR will give tax evaders a 30-day deadline to submit details of their income and spending through media advertisements and if they don't, tax authorities will raise provisional tax demands with a two-month deadline to respond. If the people do not even turn up after the two-month deadline, provisional demands will be considered as a final tax liability and after that recovery will start.

FBR has obtained information from the data bank of the National Database Registration Authority (NADRA) while evidence is based on ownership of movable and immovable property, foreign visits, and accounts in foreign banks of the tax evaders.

6. Haris Zamir, *The News*, Karachi, 6 April 2010

Only 2.75 million Pakistanis, or 1.6 per cent of the country's estimated 160 million people, are registered taxpayers and posses the National Tax Numbers (NTN), FBR report said. Out of these NTN holders, only around two million people file their returns to the tax authorities, the report said. 'The compliance ratio has always been below. The share of taxpayers to population is low when compared with the few selected developing and developed countries, where the share ranges between 4.7 per cent and 86.4 per cent.' The report said that in India, the share of taxpayers to population is 4.7 per cent, in Argentina 16.5 per cent, France around 58 per cent. 'The share of taxpayers belonging to the non-corporate sector is close to 99 per cent in the total return filers. On the other hand, the corporate sector that contributes around 66 per cent in the total income tax collection has a share of only one per cent in the income tax base.'

Pakistan's tax collection has failed to improve since the late 1990s mainly due to inherent structural problems, including a narrow tax base, massive tax evasion, and administrative weaknesses, Federal Board of Revenue (FBR) said in its quarterly report. The report said that taxpayers distrust public institutions and the tax-to-gross domestic product (GDP) ratio had declined in recent years. But in fiscal 2009/10 (July–June), the tax-to-GDP ratio is expected to rise to 9.3 per cent from 8.8 per cent in 2008/09.

In order to ensure adequate public funding for the development and safeguard macroeconomic stability, the government plans to increase tax collection to 13 to 15 per cent of GDP in the next five years, the report said. This commitment is linked with the implementation of broad-based value added tax (VAT) from fiscal 2010/11, it added. 'International experience shows that tax reform can deliver large increases in the tax-to-GDP ratio. While there are other developing countries at Pakistanis income level with similarly low tax-to-GDP ratios, countries in the region set a different example.' 'The simple average of the tax-to-GDP ratio in Bangladesh, India, and Sri Lanka—countries with similar tax policies and administration—is systematically higher than Pakistan,' the report said adding that this gap increased during the present decade.

The reports said that Malaysia, India, Thailand, Turkey, and Sweden saw rapid growth and rising tax ratios, while in Pakistan tax collection rose just in line with the economic growth. In Asia-Pacific countries, the tax collection ratio increased from 13.8 per cent in 2000 to 16.5 per cent in 2004, while in Pakistan it remained roughly constant as a per cent of GDP since the early 2000.

Exemptions are made part of the tax system for a variety of reasons including the income tax threshold and GST exemption on basic foodstuffs are granted to protect the most vulnerable groups of society, the FBR report said. Exemptions are also introduced to protect certain industries, including those which are new, it added. 'There are also political exemptions (for) diplomats, top echelon of civil and military bureaucracy, and employees of the international organizations. Temporary exemptions are also granted to address issues that arise from time-to-time.' Tax exemptions are also given for the import of essential commodities to counter inflationary pressures, it said. 'The estimated total cost of all of the exemptions that could be around Rs. 200 billion, which comes to 3 per cent of the GDP.'

The report said that Pakistan needs to look thoroughly at the available reform options, pursuing twin-track reforms of tax policy and administration, which would help the government to meet its medium-term revenue collection targets. 'Different studies conducted on Pakistan taxation system highlight that Pakistan has the potential to achieve the objective of increasing the tax to GDP ratio by 13–15 per cent over the next five years.'

been State Bank of Pakistan's profit. The second major source has been Coalition Support Fund (CSF) from the United States of America, although this depends on Pakistan-US relations. The other heads of non-tax revenue constitute profits from Pakistan Telecommunication Authority and dividend from OGDCL, Pak Arab Refinery Ltd, and PSO. Other sources include possible potential of receipts from the eventual auction of 3-G Licences—see Tables 10.4 and 10.5.

The sales tax is a tax on consumption levied on manufacturers and retailers with an annual turnover of more than Rs. 5 million, as well as on importers, wholesalers, distributors, dealers, and specified services at a standard rate of 16 per cent, as approved in the Budget of 2012/13. However, some commodities are subjected to sales tax at 19 per cent and 22 per cent and there are others, such as basic foodstuff, agricultural produce (not subjected to any further process), medicines, books, and live animals, etc. which are exempted from the sales tax.

Petroleum products and edible oil remain the top revenue source of sales tax on imports. Within the domestic component of sales tax collection, the largest contributions come from POL products, telecom, services, natural gas,

Table 10.4
Summary of Revenue Receipts I (Rs. m)

	2010–11 Revised	2011–12 Budget
B * TAX REVENUE	**1,679,363.0**	**2,074,182.1**
Direct taxes	**626,900.0**	**743,600.0**
Income Tax	602,500.0	718,600.0
Workers' Welfare Tax and	20,000.0	25,000.0
Workers' Participation Fund	0.0	0.0
Capital Value Tax	4,400.0	0.0
Indirect taxes	**1,052,463.0**	**1,330,582.1**
Customs	173,300.0	206,400.0
Sales Tax	654,600.0	836,700.0
Federal Excise	132,900.0	165,600.0
Petroleum Levy	90,000.0	120,000.0
Other Taxes (ICT)	1,590.0	1,807.1
Airport Tax	71.0	75.0
NON TAX REVENUE	**556,525.8**	**657,967.8**
Income from Property and Enterprise	**103,625.1**	**195,330.2**
Profits (Pakistan Post office)	−140.0	−2,195.0
PTA	0.0	75,000.0
Interest (Provinces)	18,508.3	15,638.1
Interest (PSEs & others)	41,775.6	52,503.4
Dividends	43,481.1	64,383.7

* Out of which FBR collection has been estimated at Rs. 1587.700 billion for R. E. 2010–11 and at Rs. 1952.300 billion for B. E. 2011–12

Table 10.5
Summary of Revenue Receipts II (Rs. m)

	2010–11 Revised	2011–12 Budget
Receipts from Civil Admn. and Other Functions	**302,640.2**	**321,382.778**
General Administration	702.3	800.5
SBP Profit	185,000.0	200,000.0
Defence	115,298.0	118,739.0
Law and Order	671.2	866.0
Community services	498.5	530.1
Social Services	384.1	447.2
Miscellaneous Receipts	**150,260.5**	**141,254.9**
Economic Services	2,213.4	2,388.3
Citizenship, Naturalization & Passport Fees	10,700.0	13,750.0
Development Surcharge on Gas	31,706.4	24,925.1
Royalty on Oil	19,604.9	15,183.1
Royalty on Gas	35,143.3	32,796.4
Discount Retained on Local Crude Oil	25,189.0	25,100.0
Others	25,703.5	27,112.0
Gross Federal Revenue Receipts	**2,235,888.8**	**2,732,149.9**
Less: Provincial Share	**997,700.7**	**1,203,321.0**
Net Federal Revenue Receipts	**1,238,188.1**	**1,528,828.9**

Revenue Receipts (Rs. m)

Classification	2010–11 Revised	2011–12 Budget
Tax Revenue	**1,679,363**	**2,074,182**
– Direct Taxes	626,900	743,600
– Indirect Taxes	1,052,463	1,330,582
Non-Tax Revenue	**556,526**	**657,968**
– Property and Enterprise	103,625	195,330
– Civil Administration and Other Functions	302,640	321,383
– Miscellaneous Receipts	150,261	141,255
Revenue Receipts (Gross)	**2,235,889**	**2,732,150**
Less: Provincial Share	997,701	1,203,321
Revenue Receipts (Net)	**1,238,188**	**1,528,829**

sugar, and cigarettes. Domestic sales tax collection also benefited from the revenue measures announced in March 2011 when the sales tax was applied on the market price of sugar. Moreover, exemptions for sales tax on fertilizers, pesticides and tractors, and zero rating on plants, machinery, and equipment including parts, have also been withdrawn. Changes in what should be taxed take place periodically as and when the government decides.

In terms of collection from federal excise duties (FEDs), there are six major areas of revenue which include cigarettes,

beverages, POL products, cement, natural gas, and special excise duty. Almost 76 per cent of excise duty collection (domestic) is collected from these six commodities. Of the total domestic collection of FED, cigarettes and tobacco, cement, and services are usually the biggest contributors. The main source of customs receipts is from the duties levied on vehicles and from POL products.

Non-tax receipts of the federal government comprise of (i) income from property and enterprise, (ii) receipts from civil administration, and (iii) miscellaneous receipts of the federal ministries, divisions and departments.

The direct tax has contributed around 40 per cent of total tax receipts. The share of direct taxes in total federal tax receipts has increased from around 15 per cent in the early 1990s to 32 per cent in 2000/01, and was 40 per cent in 2009/10. The contribution of income tax in total direct taxes has been around 95–97 per cent. The structure of income tax is based on withholding taxes (WHT), voluntary payments (VP), and collection on demand (COD). The collection during 2009/10 shows that the share of WHT, VP, and COD in gross collection was 53 per cent, 29.5 per cent, and 17.5 per cent, respectively. WHT is the leading source of direct tax receipts given the large undocumented sector of the economy. Nine major withholding taxes contributed around 92 per cent of total WHT collection in 2009/10. These were: contracts, imports, salary, telephone, export, bank interest/securities, electricity, cash withdrawal, and dividends.

The sales tax was the second major revenue generation source of the country during 2009/10. It constituted around 65 per cent and 39 per cent of the collection of indirect taxes and total federal taxes, respectively, during 2009/10. The collection of sales tax has always been highly concentrated in some commodities, with only petroleum products and the telecom sector contributing more than 60 per cent of the total domestic sales tax. Ten commodities contribute almost 90 per cent of the total net sales tax from domestic sources, and include petroleum products, telecom services, natural gas, other services, cigarettes, sugar, electrical energy, beverages, tea, and cement. Like the domestic sales tax, the receipts of sales tax on imports are also concentrated in a few sectors. Petroleum products alone contributed around 40 per cent of overall collection of sales tax on imports during 2009/10. Despite the large-scale import tariff rationalization in the last two decades, with tariffs down to a maximum of 30 per cent, customs duty is still an important component of federal tax receipts. It contributed around 20.2 per cent and 12.2 per cent of indirect taxes and total federal tax receipts, respectively, during 2009/10. Federal excise duty is levied on imports and domestic stages. The major portion of the receipts emanates from the domestic sector. The base of the federal excise duty is quite narrow and is limited to a few commodities. Despite this narrow base, the federal excise duty contributed 9.1 per cent of total tax collection during 2009/10.

Table 10.6
Principal Sources of Revenue and Expenditure for United Pakistan (Rs. m)
Part (a)

	Revenue				
Year	Customs	Central excise duty	Income tax and corporation tax	Sales tax	Total revenue receipts
1947/8	113.7	13.8	27.0		198.9
1957/8	420.5	193.7	240.4	142.7	1,525.0
1964/5	1,030.2	697.0	342.3	268.6	3,301.0
1970/1	1,700.0	2,159.7	385.0	247.6	6,461.3

Part (b)

	Expenditure						
Year	General admin-istration	Social sectors	Defence	Total expenditure	Surplus/ deficit	Total development expenditure	Total non-development expenditure
1947/8	8.2	7.2	153.8	236.0	–37.1	98.1	22.4
1957/8	68.3	86.4	854.2	1,521.8	3.2	1,457.2	125.3
1964/5	111.1	132.3	1,262.3	2,736.2	564.8	2,426.0	254.5
1970/1	188.4	301.2	3,200.0	6,002.6	458.7	4,725.8	941.0

Source: Government of Pakistan, *Pakistan Economic Survey 1972–73* (Islamabad, 1973), 170–1.

Prior to the passing of the 18th Amendment and the 7th NFC Award, about 90–93 per cent of resources were generated at the federal level whereas only 7 per cent resources were generated by the provinces. Provinces relied on the federal government for meeting their expenditure requirements. In order to maintain inter-governmental fiscal relationships, Article 160 of the Constitution provides for setting up of the National Finance Commission (NFC) at intervals not exceeding five years. The mandate of NFC is to recommend to the President for the distribution of resources between the federal and provincial governments—see Chapter 13 for details on the NFC

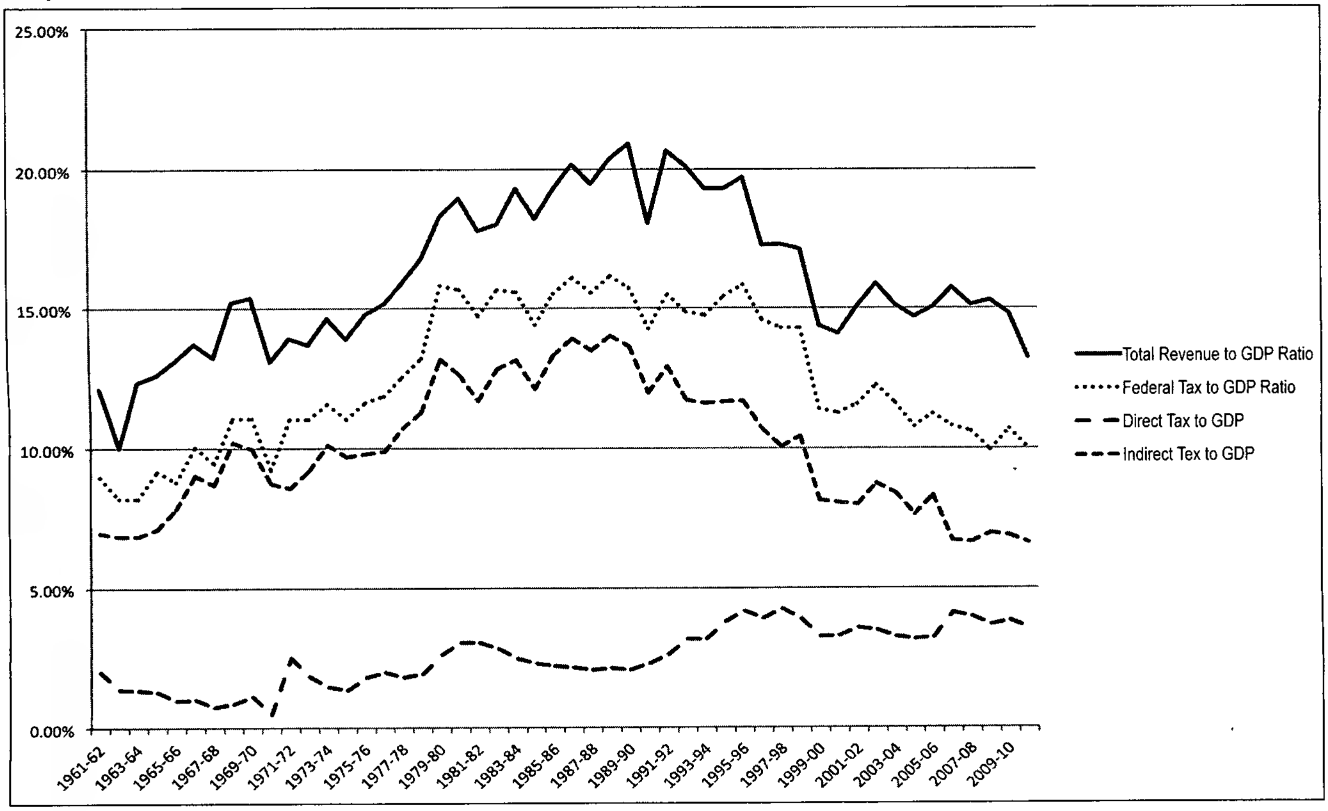
10.3 Public Finance: The Basic Facts

As has been the pattern in much of this book, having introduced the subject of public finance in Pakistan, we now present some data. This section is made cumbersome by the extensive nature of public finance statistics covering three tiers of government: federal, provincial, and local. Nevertheless, in order to appreciate the issues involved, a study of hard data is unavoidable.

Of the tables that follow, Tables 10.6 to 10.11 provide basic and historical information and data about the nature of Pakistan's public finances. Table 10.6 presents the expenditure and revenue pattern in Pakistan prior to the independence of Bangladesh. It shows that the main source of revenue has historically been from customs duties, i.e. taxation on trade. This should not be very surprising if Part II of this book has been studied, where the contribution of trade has been shown to be substantial in economic development. With high tariff barriers and import substituting industrialization, this is a logical outcome. Taxes from imports were, until recently, the main source of revenue for the exchequer. Another interesting figure on the revenue side in Table 10.6 is the contribution of income and corporation taxes. Despite the impressive industrialization and dynamic economic growth that took place in the 1960s, the contribution of income and corporate taxes actually *declined* as a percentage of total revenue receipts for United Pakistan. From 15.7 per cent in 1957/8, they fell to less than 6 per cent in 1970/1. The issue of income tax is discussed in subsequent sections of this book, but it seems that the pattern of tax evasion and underreporting may have been established very early in Pakistan.

On the expenditure side, it seems that Pakistan's was an economy of defence, with more than half of total expenditure being spent on defence from 1947 to at least 1970/1. In 1970/1, 53 per cent of total expenditure was on defence, a figure astronomically high by any standards. Because Pakistan's economy, up to the 1970s, was highly dependent on external resources in the form of aid, grants, and foreign debt, development expenditure was higher than non-development expenditure. In 1962/3, for example, of the total resources available to spend in Pakistan, as much as 73 per cent were external funds; in 1966/7, this figure was 74 per cent. As soon as the military government of Ayub Khan took control of Pakistan in 1958, the share of external

Graph 10.1: Revenue Statistics of Federal Government 1961/2–2010/11



funds in total resources jumped to over half. The arguments made in Chapter 6, that Pakistan's economy was highly dependent on aid and that much of the industrialization boom of the Decade of Development was foreign funded, are re-emphasized on the basis of public finance data for those years.[19]—also see Chapter 25.

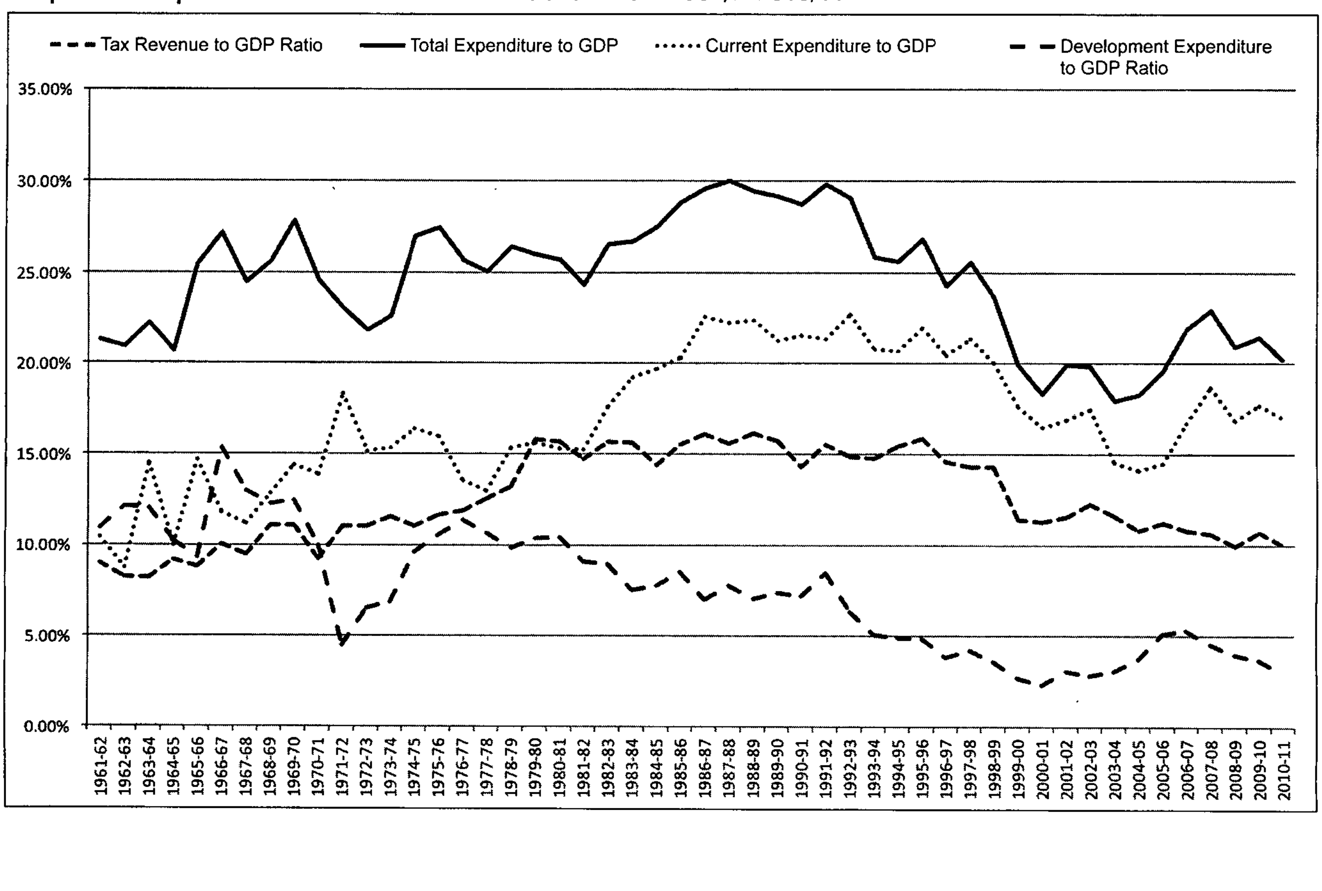
To understand the nature of public finance statistics, Tables 10.7 to 10.11 provide a good introduction. Table 10.7 gives a basic overview of how the Government of Pakistan presents its consolidated provincial and federal government expenditure and revenue, and includes figures on development expenditure and on the extent of the fiscal deficit and its funding for each year. What is interesting from Table 10.7 is that even after 26 years of structural reforms, very little has changed, and in fact, in the case of tax revenues as a per cent of GDP, there is substantial deterioration. Tables 10.8 and 10.9 break down the revenue and expenditure statements of the government in greater detail.

In Table 10.8, we see that revenue from taxation is far greater than that from non-tax revenue, and that indirect taxes continue to be many times as large as direct taxes. Within the category of indirect taxes, import duties used to dominate by far, and provided the largest source of income to the government. This has all changed and has been one of the most significant changes in Pakistan's economy as a result of lowering tariffs and overall reforms. Today the sales tax is the largest source of revenue to the government. On the expenditure side (Table 10.9), development expenditure is far lower than current or non-development expenditure, and in 2011/12 was less than 19 per cent of total provincial and federal current expenditure. This pattern contrasts sharply with that seen in the period prior to 1971. The data also show that defence and interest payments accounted for more than half of all government expenditure. This issue is of key importance to the economy and politics, and is discussed in greater detail in this chapter and the next.

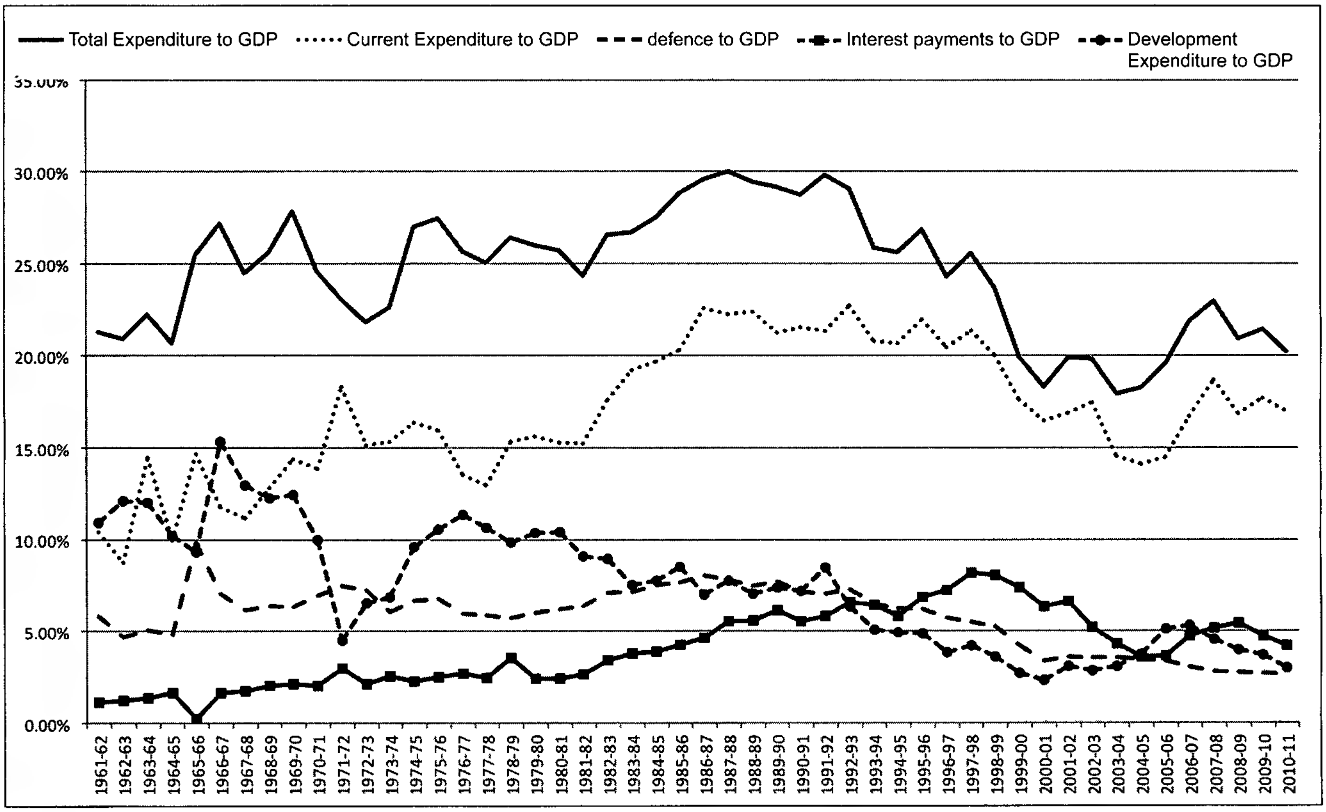
Since the figures in Tables 10.7 to 10.9 are in current market prices, a more useful indication of trend is a measurement of these figures with respect to a constant, say GDP. Table 10.10 shows how total revenue has fallen over the last decade and ranges around 9 per cent of GDP. Tax revenue is only around 6.8 per cent and is cause for serious concern. Figure 10.2 shows the almost unchanging trend and relationship between tax and non-tax revenue since 1986/7.

Shahid Kardar explains the range of the problems Pakistan has in collecting taxes, and argues, that Pakistan has one of the lowest tax to GDP ratios and, even considering developing countries alone, it is in the bottom ranked nations in terms of the proportion of population registered as taxpayers—less than 5 per cent of household population. There is rampant tax evasion, partly with the collusion of the official machinery. Whereas 3.1 million people have the National Tax Number, a mere 1.2 million filed an income tax return in 2010/11. What is even more startling is that of 47,800 companies that have NTNs, less than 16,800 filed an income tax return against 400,000 industrial electricity connections. As admitted by FBR, there is a tax gap of 79 per cent (the difference between potential revenues under the existing system and those

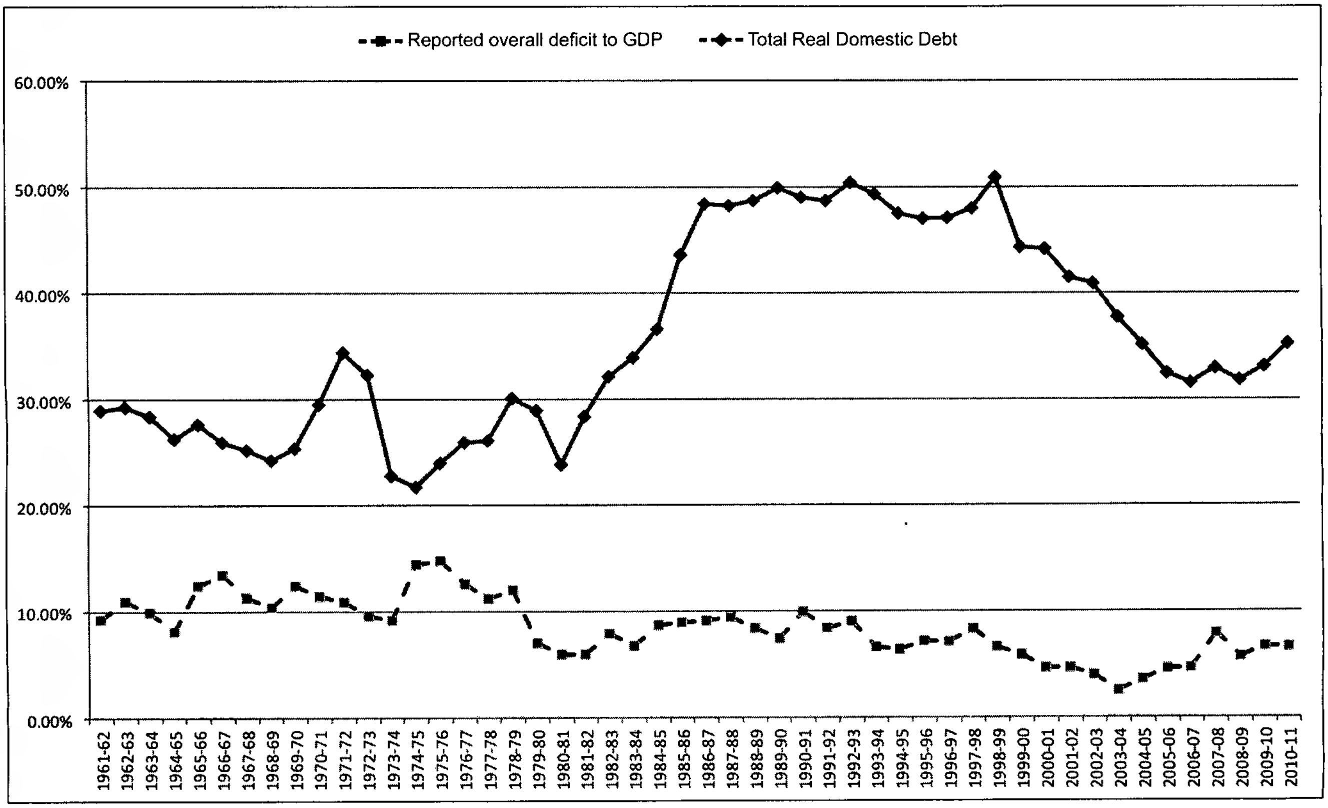
Graph 10.2: Expenditure Statistics of Federal Government 1961/2–2010/11



Graph 10.3: Expenditure Statistics of Federal Government 1961/2–2010/11



Graph 10.4: Fiscal Deficit and Debt Statistics of Federal Government 1961/2–2010/11



actually collected).[20] See Appendix 10.3 for a proposal to reform Pakistan's taxation system.

At the end of the fiscal year 2011/12, the size of Pakistan's economy was estimated at Rs. 20.653 trillion. Over the last decade, the tax-to-GDP ratio fell from around 11.5 per cent in 2002/3 to 8.5 per cent in 2011/12. Hence, if the tax-to-GDP ratio would have been maintained at even the low level of 2002/3, the additional tax revenue accruing to Pakistan's economy would be Rs. 600 billion, enough to address the energy crisis in terms of the outstanding circular debt. If Pakistan's proportion of taxpayers was the same as that of India's, a low 4.7 per cent of the population, then Pakistan's tax paying population should have been more than three times what it is today, and this when India's tax model has numerous problems similar to Pakistan's. See Box 10.3 for one of many assessments of Pakistan's tax-to-GDP ratio.

Table 10.11 shows how government expenditures have grown over time and the extent of allocation to different expenditure heads. One sees that while defence and interest payments have shown only positive, at times dramatic, increases over the previous year, development expenditure has even been cut, by equally dramatic amounts, in some years. What is more alarming from the lower panel in Table 10.11 is that the proportion of development expenditure in total expenditure, while very low, has continued to fall over the last decade with an increase in allocation, after having fallen markedly, in the last two years. Table 10.12 looks at these expenditure figures as a proportion of GDP, and shows that interest payments and defence consume almost half of total expenditure.

Having provided an overview of public finance statistics, we can now examine some of the key public finance ratios in Pakistan over a period of about fifty years, as shown in Table 10.13. While there has been some change in tax revenue as a proportion of total revenue in the last fifty years, the change has not been very substantial except in the last decade. Moreover, most ratios—those for direct taxes, indirect taxes—have not shown much change, although the nature and structure of the economy has changed considerably in fifty years. One should have expected changes in the revenue structure along with structural changes in the economy and the main change comes about due to a fall in customs duties over the last decade. There are significant changes, however, on the expenditure side, where debt servicing has increased quite substantially over the five decades. The dependence on external resources, if high in the 1960s and 1970s, was even higher at the end of the 1980s.

So far we have been discussing largely consolidated figures. Before we turn to a disaggregation of revenue and expenditure patterns at different levels of government, Table 10.14 shows us the degree and role of each level of government in revenue and expenditure. The federal government collected about 90 per cent of total revenue and of tax receipts, while the local government did as well as the provincial government, despite numerous constraints and obstacles in raising revenue. Since the federal government provided provincial government's funds, the provinces' share of development expenditure was greater than the revenue they raised. In 2001, while provincial governments collected 5 per cent of total revenue receipts, they spent 31 per cent

Table 10.7
Summary of Public Finances: 1987/8, 2002/3 and 2011/12

	1987/8		2002/3[d]		2011/12	
	Rs. m	% of GDP	Rs. m	% of GDP	Rs. m	% of GDP
Total revenues	117,021	17.3	706,100	17.6	2,568,060	12.8
Federal	110,949		660,300		2,412,843	
Provincial[a]	6,072		45,800		155,217	
A Tax revenues	93,456	14.3	553,300	13.8	2,077,392	10.3
Federal	88,958		530,200		1,970,203	
Provincial	4,498		23,100		107,189	
B Non-tax revenues	23,565	3.7	152,800	3.8	490,668	2.4
Federal	21,991		130,100		442,640	
Provincial	1,574		22,700		48,028	
Surplus of autonomous bodies and SAP[c]	5,789		5,000		–	
Expenditures	180,373	26.7	892,500	22.2	3,973,764	19.6
Federal	136,151		318,057		–	
Provincial	44,222		110,224		–	
Current[a]	133,645		728,800		3,122,502	
Federal	104,200		543,700		2,154,732	
Provincial	29,445		185,100		967,770	
Development	46,728		134,000		731,868	
Federal	31,951		60,100		–	
Provincial	14,777		21,800		–	
Overall deficit	57,563	8.5	186,400	4.6	1,369,704	6.8
External (net)	12,691		102,500		128,650	
Domestic (non-bank)	30,931		101,100		529,384	
Banking system[b]	13,941		29,200		711,670	
Memorandum items						
GDP at market prices (Rs. bn)	0.675		4.01		20,091	

[a]Current subsidies are included in current expenditure and development subsidies in development expenditure.
[b]Differs from monetary statistics due to coverage and timing.
[c]SAP from 1992/3.
[d]Modified Budget Estimates.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Table 10.8
Consolidated Federal and Provincial Government Revenues: 1987/8, 2002/3, and 2011/12 (Rs. m)

	1987/8	2002/3[d]	2011/12
Total revenues (I + II)	117,021	706,100	2,568,060
Federal[a]	110,949	660,300	2,412,843
Provincial[a]	6,072	45,800	155,217
I Tax revenues (A + B)	93,456	553,300	2,077,392
Federal	88,958	530,200	1,970,203
Provincial	4,498	23,100	107,189
A Direct taxes (1 + 2)	12,441	152,072	746,656
1 Income and corp. tax[b]	11,528	54,300	–
2 Taxes on property	913	5,076	–
Federal	313	3,700	–
Provincial	600	1,376	–
B Indirect taxes (3 + 4 + 5 + 6 + 7)	81,015	397,657	1,330,736
3 Excise duty	17,560	49,095	126,656
Federal	17,399	47,500	122,460
Provincial	161	1,595	4,195
4 Sales tax[b]	8,743	204,000	808,846
5 Taxes on international trade	38,001	59,000	216,898
6 Surcharges[b]	12,974	66,000	83,329
6.1 Gas[b]	3,075	18,000	22,960
6.2 Petroleum[b]	9,899	48,000	60,369
7 Other taxes[c]	3,737	19,562	99,008
7.1 Stamp duties[c]	1,671	6,554	16,522
7.2 Motor vehicle taxes[c]	856	3,585	11,140
7.3 Foreign travel tax	–	1,710	0
7.4 Others[c]	1,210	7,713	71,341
II Non-tax revenues	23,565	152,800	490,668
Federal	21,991	130,100	442,640
Provincial	1,574	22,700	48,028

[a]Since consolidated revenues are invariant to 'Transfers to provinces', adjustment for such transfers has not been made in the federal and provincial figures.
[b]Revenues under these heads are exclusively federal.
[c]Revenues under these heads are exclusively provincial.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Table 10.9
Consolidated Federal and Provincial Government Expenditure: 1987/8, 2002/3, and 2011/12 (Rs. m)

	1987/8	2002/3[c]	2011/12
Current expenditure[a]	133,645	728,800	3,122,502
Federal	104,200	543,700	2,154,732
Provincial	29,445	185,100	967,770
Defence[b]	47,015	158,000	507,159
Interest	33,238	241,829	901,919
Federal	31,702	212,300	889,044
Provincial	1,536	29,529	12,875
Current subsidies	7,950	59,135	166,976
Federal	4,332	49,800	–
Provincial	3,618	9,335	–
General administration	8,642	101,223	
Federal	5,098	57,900	
Provincial	3,444	43,323	
All others	19,575	168,613	
Development expenditure	46,728	134,000	731,818
Total expenditure	180,373	892,500	3,937,764
Federal	136,151	318,056	
Provincial	44,222	110,224	

[a]Current subsidies are included in current expenditure and development expenditure.
[b]Expenditures under these heads are exclusively federal.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

of total government expenditure. On the other hand, local government's share of total expenditure was about the same as the revenue it raised (see Figure 10.3). However, as Chapter 13 explains in greater detail, these proportions have changed after the 18th Amendment.

Tables 10.15 to 10.17 show in greater detail the federal government's revenue receipts over the last few years and provide a far more relevant comparison of the different types of tax and their shares. While the share of income tax has increased since 1983, as has that of the sales tax, indirect taxes still constituted almost 60 per cent of the total taxes collected in 2010. Figures 10.4 and 10.5 depict these changes

Table 10.10
Summary of Public Finance: Consolidated Federal and Provincial Governments: 1978–2013 (% of GDP at Market Prices)

	1960s average	1978/79	1970s average	1980/1	1980s average	1990/1	1998/9	1990s average	2004/5	2012/13[P]
Total revenues	13.1	15.7	16.8	16.9	17.3	16.9	15.9	17.1	13.8	9.3
Tax revenues		12.9		14.0	13.8	12.7	13.3	13.4	10.1	6.8
Non-tax revenues		2.8		2.9	3.5	4.2	2.6	3.7	3.7	2.5
Expenditures	11.6	25.1	25.1	22.9	24.9	25.7	22.0	24.1	17.3	13.9
Development Expenditure		–		9.3	7.3	6.4	3.4	4.7	3.9	1.9
Overall deficit	2.1	8.9	5.3	5.3	7.1	8.8	6.1	6.9	3.3	4.6

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).
[P] = Provisional

Table 10.11
Consolidated Federal and Provincial Government Expenditure: 1971–2011

	1971/2	1976/7	1980/1	1987/8	1990/1	1996/7	1997/8	1998/9	1999/00	2004/5	2010/11
Growth rate over preceding period (%)											
Current expenditure	–	–	–	15.0	–	7.4	16.4	3.3	14.5	4.5	16.9
Defence	–	–	–	13.7	–	6.5	6.8	5.4	4.8	14.5	20.2
Interest	–	–	–	38.7	–	21.6	25.6	8.8	19.1	5.6	8.4
Current subsidies	–	–	–	36.7	–	11.1	–25.8	70.1	54.6	8.8	14.8
General administration	–	–	–	–17.8	–	–4.0	33.8	9.0	37.6	–	–
Others	–	–	–	1.4	–	–8.2	11.2	–16.0	–3.3	–	–
Development expenditures	–	–	–	29.2	–	–9.3	21.7	–5.6	–2.7	41.4	–2.3
Total expenditure	–	–	–	18.4	–	4.4	17.2	2.2	9.5	16.8	14.9
As percentage of total expenditure											
Current expenditure	68.1	45.6	62.7	74.1	75.0	84.2	83.6	84.5	88.3	77.4	84.0
Defence	44.5	26.1	24.5	26.1	24.8	23.6	21.5	22.1	21.2	19.0	13.0
Interest	11.9	6.0	9.3	18.4	19.2	29.8	31.9	34.0	37.0	21.0	20.7
Development expenditures	31.9	54.4	37.7	25.9	25.0	15.8	16.4	15.5	11.7	22.6	14.9

[a] Modified Budget Estimates.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

over time quite starkly. While the issue of income tax, the sales tax, and the proportion of direct to indirect taxes is discussed in greater detail in later sections of this chapter, it is interesting to see how Pakistan performs compared to similar underdeveloped countries. Table 10.18 provides such a comparison.

From the table it seems that, as GDP rises, the share of total taxes should also rise, and direct taxes, in particular, should play a greater role in the overall taxation structure of the country. Pakistan's tax effort is quite poor compared even with countries with similar levels of income, especially in the case of direct taxes. At 3.91 per cent of GDP, even poorer countries had a better tax effort than Pakistan. Indirect taxes do not vary all that much, although, not surprisingly, as income grows, foreign indirect taxes are also expected to increase. Hence, while a growth factor is important, tax effort and special effort also play an important role.

Like Table 10.12, Table 10.19 provides a similar comparison across five decades. Direct taxes have not shown much change, although indirect taxes, and in particular import duties, had increased substantially. There is also an increase in excise duties and the sales tax. Indirect taxes are often consumption taxes, which means that, as the economy grows and as the demand for and consumption of goods also increases, so does the revenue collected from the taxes on those goods. This is clearly visible from the table in the case of Pakistan, which corroborates the international evidence shown in Table 10.18.

Box 10.4 explains the measures of elasticity and buoyancy in the tax structure, and Tables 10.20 and 10.21 show the extent of both for some important taxes. The elasticity coefficient of a tax measures the built-in response of tax revenue to growth in income, without any change in the tax rate, while the buoyancy coefficient measures the total responsiveness in the tax revenue to the growth of income, inclusive of changes in tax revenue. Table 10.20 shows that except for the sales tax, and for income tax during 1972/3 to 1980/1, the elasticity figures were less than 1, implying that a 1 per cent increase in income increases tax revenue by less than 1 per cent. Customs duties and the sales tax had a buoyancy of more than 1, while excise duties and income tax had a less-than-1 buoyancy, implying that inclusive of all

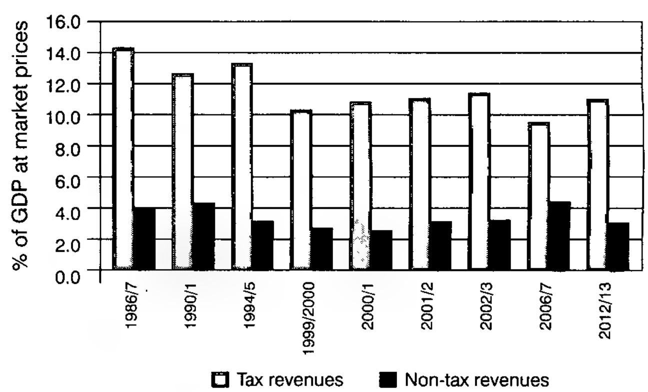


Figure 10.2
Tax and Non-Tax Revenue: 1986–2013 (% of GDP)

Box 10.3

FBR and the Tax-to-GDP Ratio

1. The frequent changes in tax legislation have distorted the overall tax structure, which has played a key role in lowering tax-to-GDP ratio in Pakistan. Sources told *Business Recorder* here on Wednesday that a report on the tax gap analysis revealed that frequent changes in tax legislation has made the overall tax structure incoherent and tax base narrow: Tax policy reform in Pakistan has often been piecemeal and disconnected.

   Many changes in the tax system were either made to cater to the interest of specific economic sectors or firms, or introduced as matter of administrative convenience, as was the case of zero rating of five sectors. The government does not know the revenue losses of the incentives given, and has no rigorous system to evaluate the objectives and benefits.

   These policies have contributed to the narrowing of the tax base and the decrease in tax effort. They have also compromised the fairness of the tax system, reduced voluntary compliance and increased tax. Sources said that the main problem with the tax system is its sustained inability to raise adequate revenue to finance the public sector budget. In fact, over the 2000s tax revenue has barely kept pace with GDP, and the tax revenue to GDP ratio even declined in the last years of the decade. Based on international comparisons, Pakistan is a low taxing country. Given the large development needs for social services and public infrastructure, there remains a structural fiscal gap equivalent to about five per cent of GDP.

   The efficiency costs of the tax system to the economy are high: Pakistan''s tax system levy taxes on different economic sectors and types of assets at very different marginal effective tax rates, which create significant distortions. Although some distortions may be intentional, the real consequence of the distortions is that many investment decisions are guided by tax considerations as opposed to economic considerations.

   The result is an overall less efficient allocation of resources and lower levels of output and rates of economic growth for Pakistan. These distortions are caused, among other issues, by the favourable treatment of certain investments and sectors.

   The report said that currently, the tax laws are such that individuals with the same income or businesses with the same profits can be treated very unequally in terms of the final taxes the law requires them to pay. This report shows that gap estimates vary widely across sectors. The horizontal unfairness of the tax system is exaggerated by the uneven application of tax enforcement: while compliant taxpayers bear the full burden of taxes, the failure of tax enforcement mechanisms allows other taxpayers to evade their taxes with a large degree of impunity.

   Even though the basic structure of Pakistan's tax system is broadly in line with international practice, these taxes have become more complex over the years, because of exemptions, other preferential treatments, and ad hoc changes to the structure of those taxes. The extensive use of withholding taxes, often being considered a final tax—as opposed to being adjustable against final full liabilities—has added to the complexity and arbitrariness of the tax system. The inadequate standards in maintaining tax data do not allow a complete study of the impact of these distortions, sources said.

   In spite of partial reforms, there is a long way to go to fully modernise the tax administration. This long-standing bottleneck is characterized by over-reliance on easier 'tax handles' through an extensive system of withholding taxes, inefficiencies in administrative structure and operations, and weak enforcement. Around 58 per cent of the legal tax base still goes untapped. The situation gives rise to the inadequacy of revenue yields and loss of confidence in the fairness of the system due to large horizontal inequities, sources added.

Source: Sarfaraz, Sohail, 'Tax-to-GDP Ratio Lowered', *Business Recorder*, 15 March 2012.

2. The Federal Board of Revenue (FBR) has identified factors like exemptions and narrow tax base as major reasons for high tax gap in Pakistan.

   Tax gap analysis has revealed that there are several factors contributing to the high tax gap in Pakistan. The structural problem, such as a narrow tax base due to exemptions exists with tax evasion and distrust of public institutions, and administrative weaknesses, all also taking a toll on tax collection. Recent reviews of tax returns reveal that even compliant taxpayers do not provide essential information in the returns. Due to these discrepancies in the returns, a number of opportunities for underreporting income or claiming lower rates and liabilities are generated. As better quality data becomes available, a more refined analysis will be possible to highlight specific issues in individual sectors.

   International experience shows that tax reform can deliver large increases in tax effort. The countries with income levels comparable to Pakistan generate higher tax-to-GDP ratios. The simple tax-to-GDP ratio in Bangladesh, India, Nepal and Sri Lanka are systematically higher than Pakistan's despite these countries having similar tax policies and administrations.

   In Asian and Pacific countries overall, central government tax collections increased from 13.8 per cent in 2000 to 16.5 per cent by middle of the decade, it remained almost constant in Pakistan and then declined with the global economic crisis.

   Sources said that the gap analysis in the report corroborates the worries that tax revenue in Pakistan is raised in an inefficient way, favouring certain sectors and economic activities over others. Such incidence of taxation can deter people from investing the most productive sectors and earning more from the resource available and ultimately adversely affect economic growth. Some sectors are much more heavily taxed compared to their

contribution to GDP than other sectors. It is already known that about one fifth of GDP comes from agriculture, yet this sector yields no more than 1 per cent in FBR revenues. Services make up almost half of economic value added, but generate only one quarter of central taxes due to the low tax receipts from wholesale, retail, and transport. Given the shortfall in agriculture and services, industry carries the brunt of the tax burden—its tax share is three-times as high as its GDP share.

Within the industrial sector the variations in tax gap estimates demonstrate the unequal incidence of taxation. In addition, there are question marks to what extent the tax system, through the way it treats different income classes of people differently, is sufficiently equitable. While some progress has been made, Pakistan's tax code remains complicated and most taxpayers have little knowledge of their obligations, sources referred to the report.

Sources said that Pakistan can take measures to increase the tax to GDP ratio by around 3.5 percentage points over the medium-term. In order to ensure a healthy long-run economic development, Pakistan needs to embrace substantial changes in tax policy aimed at increasing the buoyancy of the tax system, broadening the tax base. The measures like reduction in distortions and phasing out exemptions will contribute to closing the tax gap. Such tax reforms are also required to deal with the risks stemming from sustained large budget deficits, sources added

Source: *Business Recorder*, 15 March 2012. This news item has been slightly edited.

the discretionary measures, a 1 per cent increase in income, would result in less than 1 per cent change in tax revenue. The reasons for the low elasticity include the presence of a large black economy and tax evasion, the presence of a wide array of exemptions, and a poor and corrupt tax administration system.

We can now move from federal taxes to the provincial tax structure. As explained earlier, the NFC award of 1991 suddenly put all four provinces into a surplus position, as seen in Table 10.22. However, what the table reveals is that provinces' own revenue effort fell appreciably after 1990/1, and development expenditures, which were mainly the responsibility of the provinces (see Table 10.23) either decreased, as in the case of the Punjab, or did not show much improvement, in the other three provinces. Education, health, and water supply and sanitation were the main sectors where the provincial governments dominated, and in 1991 overall 64 per cent of expenditure on the social sectors was incurred at the provincial level. Table 10.24 nevertheless, shows that considerable effort to increase revenue had been made. All the provinces made considerable progress, especially Sindh, which registered double-digit growth in almost all taxes. Karachi's contribution in raising revenue for the whole of Sindh is likely to be quite substantial. The increase in electricity duty, due to Karachi's very large industrial and population base, that for hotels due to Karachi's dominance of larger hotels, and other duties, such as on stamps and on property mainly from Karachi, have in all likelihood resulted in this increase for Sindh overall.

Table 10.25 is an extensive summary of most fiscal indicators from the period 1961/2 to 2010/11, and Figures 10.6 to 10.9, visually demonstrate some key trends from the table.

Let us now turn to the more substantive issues in the taxation debate and examine the causes of many of the ratios and the consequences of some of the trends discussed in this section.

10.4 Key Issues in Taxation

10.4.1 Federal Taxes

Hafiz Pasha summarizes the key features and problems of the (federal) tax system as follows:

> Pakistan's tax system is characterized by a number of structural problems. First, the overall level of fiscal effort is low and the tax-to-GDP ratio has remained, more or less, stagnant

Table 10.12
Composition of Government's Total Expenditure: 1971–2003 (% of GDP)

	1971/2	1977/8	1980/1	1990/1	1998/9	2002/3	1980s average	1990s average
Current expenditure	10.4	10.8	13.6	19.2	18.6	16.4	17.6	19.4
Development expenditure	4.9	9.9	9.3	6.4	3.4	2.2	7.3	4.7
Defence expenditure	6.8	5.5	5.0	6.3	4.9	3.3	6.5	5.6
Interest payment	1.8	1.7	2.1	4.9	7.5	4.9	3.8	6.8

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Table 10.13
Key Public Financial Ratios and Selected Years

Revenue receipt of federal government	1964/5	1972/3	1985/6	1989/90
Tax revenue as % of TR	73	75	80	76
Non-tax revenue as % of TR	27	25	20	24
Direct tax as % of TXR	14	13	14	14
Indirect tax as % of TXR	83	87	86	86
Custom duties as % of TXR	43	44	41	46
Excise duties as % of TXR	23	37	22	21
Sales duties as % of TXR	11	5	7	18
TAX to GDP ratio	9	9	14	14
External resources as % of total capital exp.	49	48	58	73
Internal resources as % of total capital exp.	20	52	42	45
Debt servicing as % of total exp. of fed. govt.	3	6	27	39
Internal debt servicing as % of total recurring exp.	5	3	6	21
Ratio of development exp. to non-development exp.	1:3	1:2.8	1:2.3	1:2.6
Federal tax assignment as % of provincial receipts	16	14	31	39
Federal govt's recurring exp. in total recurring exp.	72	68	76	80
Prov. govt's recurring exp. in total recurring exp.	28	22	24	20
Budget deficit as % of GDP	–	–	8.1	6.5

Source: Applied Economics Research Centre (AERC), *Resource Mobilization by Federal Government in Pakistan*, Research Report No. 91 (Karachi: AERC, 1992), 67.

at between 12 to 13 per cent. This is one major explanation why budget deficits have been high, generally in excess of six per cent of the GDP. Second, there is overdependence on indirect taxes, which until recently accounted for a share in revenues of over 80 per cent. This has increased the regressivity of the tax system and imposed a higher excess burden of taxation. Third, within indirect taxes there is domination of taxes on international trade, which has promoted inefficiency, distorted the allocation of resources and encouraged illicit trade. Fourth, the effective tax bases of most taxes is narrow due to wide ranging exemptions and concessions and rampant tax evasion. For example, there is less than one income tax assessee per 100 persons and less than 60 per cent of imports actually pay duty. Consequently, tax rates have had to be pitched at high levels which has created a vicious circle of more tax base erosion and higher tax rates. Fifthly, tax administration is characterized by primitive and out-moded procedures, complex laws and considerable arbitrariness and discretion. The common perception is one of high levels of corruption and inefficiency.[21]

The World Bank, in its extensive evaluation of the economy prior to the commencement of the first major Structural Adjustment Programme of 1988,[22] identified the issues of resource mobilization and the budget deficit as amongst the most important. Revenue generation was to be given special emphasis in any sort of adjustment programme, as the World Bank argued that, unless this area of the economy was put in order, much of the rest of the efforts would also fail (see Chapter 11 and Part VI of this book). Many years later, following the 2009 IMF stabilization loan, the programme was cancelled in 2010 by the IMF, because Pakistan was not able to raise revenue through new taxes in the form of a

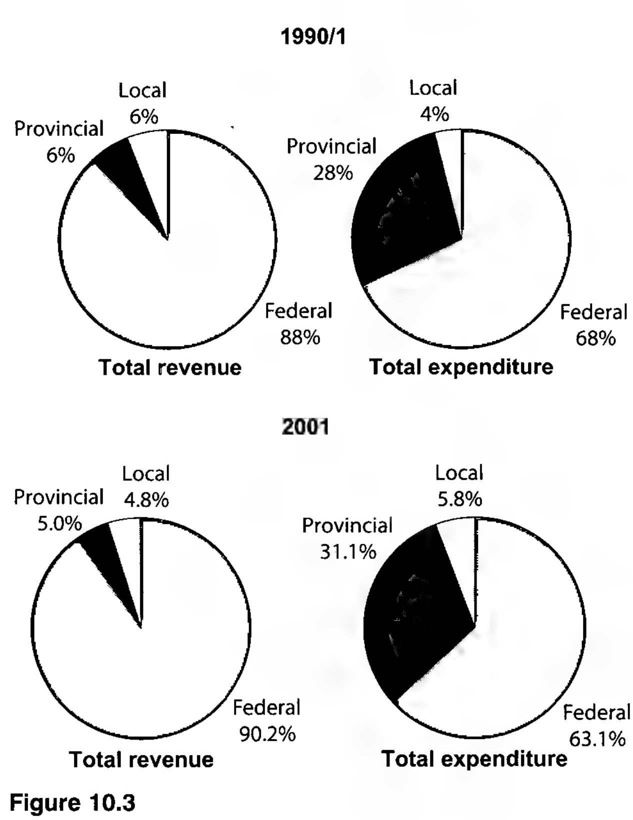


Figure 10.3
Total Revenue Receipts and Expenditure: 1990/1, 2001

Table 10.14
Share of Different Levels of Government in Revenues and Expenditure[a] in Pakistan: 1979/80, 1990/1, and 2001 (Rs. m)

Revenue/expenditure category	1979/80 Level	1979/80 Share (%)	1990/1 Level	1990/1 Share (%)	2001 Share (%)
Tax receipts	41.3	100.0	136.2	100.0	100.0
Federal	36.5	88.4	120.6	88.5	90.2
Provincial	2.3	5.6	6.8	5.0	5.0
Local	2.5	6.0	8.8	6.5	4.8
Total revenue receipts	50.0	100.0	214.7	100.0	–
Federal	44.1	88.2	189.5	88.2	–
Provincial	2.8	5.6	13.0	6.0	–
Local	3.1	6.0	12.2	5.8	–
Current expenditure	39.6	100.0	241.9	100.0	–
Federal	28.8	72.7	171.6	70.9	–
Provincial	9.1	23.0	63.3	26.2	–
Local	1.7	4.3	7.0	2.9	–
Development expenditure	26.6	100.0	76.6	100.0	–
Federal	20.9	78.6	48.0	62.7	–
Provincial	4.9	18.4	23.3	30.4	–
Local	0.8	3.0	5.3	6.9	–
Total expenditure	66.2	100.0	321.6	100.0	100.0
Federal	49.7	75.1	219.6	68.3	63.1
Provincial	14.0	21.1	89.5	27.8	31.1
Local	2.5	3.8	12.5	3.9	5.8

[a]For the country as a whole, in view of the difficulty in allocating federal expenditure to each province.

Source: Hanif, Naveed, 'The Structure of Government in Pakistan, *News on Friday,* 25 August 1995; for 2001, Anjum, Zulqarnain, 'New local government system: A step towards community empowerment?' *The Pakistan Development Review*, Vol. 40, No. 4, Part II, 2001, 858.

Value Added Tax. Revenue generation has been a perennial problem in Pakistan, one which is at the core of taxation and the political economy of revenue generation.

The World Bank report argued that the budget potential of an increase in resource mobilization comes from strengthening Pakistan's tax base, since tax revenues accounted for only 13–14 per cent of GDP, a figure far less than that of other countries at similar levels of development, which, as Table 10.25 shows, has fallen considerably from even this dismal figure. The income elasticity of the tax system is low because of the very narrow tax base and the large number of exemptions given in sales tax, excise duty, income tax, and customs duties. The pre-Structural Adjustment Programme report emphasized that there was a need to 'broaden the tax base and increase the elasticity of the tax system by shifting the emphasis in indirect taxes towards domestic consumption

Table 10.15
Federal Tax Receipts (net): 1983–2012 (Rs. m)

Year (1)	Indirect taxes: Customs (2)	Central excise (3)	Sales tax (4)	Total (5)	Direct taxes: Income tax (6)	Wealth tax (7)	Gift tax (8)	Capital value tax (9)	Estate duty (10)	W.W. fund (11)	Total (12)	Total federal taxes (13)
1983/4	21,532	15,652	4,624	41,808	8,573	163	17	–	1	34	8,788	50,596
1990/1	50,528	23,239	17,008	90,775	19,079	496	–	105	–	188	19,868	110,643
2002/3	68,836	44,754	195,139	308,729	145,366	228	–	608	–	5,693	151,898	460,627
2009/10	160,273	124,784	516,348	801,405	496,632	23	–	4,002	–	25,320	525,977	1,327,382
2011/12	216,906	122,464	804,899	1,144,269	710,018	6	–	126	–	27,275	738,425	1,882,694

Source: Federal Board of Revenue, *FBR Year Book* (Islamabad: various years).

Table 10.16
Taxes and their Distribution: 1983–2012
(% Share in Total Tax)

Year	Income tax	Other direct taxes	Customs	Central excise	Sales tax
(1)	(2)	(3)	(4)	(5)	(6)
1983/4	17.00	0.40	42.60	30.90	9.10
1990/1	17.30	0.70	45.60	21.00	15.40
2002/3	31.56	1.40	14.94	9.72	42.36
2009/10	37.41	2.21	12.07	9.40	38.90
2011/12	37.77	1.46	11.52	6.50	42.75

Source: Federal Board of Revenue, *FBR Year Book* (Islamabad: various issues).

Table 10.17
Distribution of Direct and Indirect Taxes: 1983–2013
(% Share in Total Taxes)

Year	Direct tax	Indirect tax
1983/4	17.40	82.60
1990/1	18.00	82.00
2002/3	32.98	67.02
2009/10	39.63	60.37
2012/13	39.10	60.90

Source: Federal Board of Revenue, *FBR Year Book* (Islamabad: various issues).

(of both domestic and foreign products) and raising the contribution of the income tax'.[23] An extension of the sales tax to transform it into a consumption-type value added tax (VAT) needed to be imposed at the manufacturers' level. A theme which continues to be repeated in most analysis of the taxation structure, the need to subject agricultural income to taxation, was also identified by the World Bank. All subsequent analyses of the taxation and revenue system of Pakistan, have underscored these problems—see Boxes 10.5 to 10.7 for key issue and constraints in Pakistan taxation system.

While the need to increase direct taxes as a share of total tax revenue has been an important realization, attempts to change the structure of indirect taxes have found equal emphasis. With trade taxes by far the key feature of Pakistan's taxation regime in the past, Pakistan's resource mobilization efforts have been subject to impacts not necessarily of Pakistan's own doing. Hence, the need to develop another sort of tax that is consumption based and domestic. The World Bank report identified the need for a sales tax and highlighted various problems prior to attempts to remedy them in the Structural Adjustment Programme of 1988:

> The objective for indirect taxation is to shift the emphasis from imports toward a broad-based tax on domestic consumption that is neutral between products made in Pakistan and imports. This would involve a modification of Pakistan's present *sales and excise taxes*. In principle, all goods produced/manufactured in Pakistan and sold wholesale are now subject to a sales tax, but practice has differed from principle. So many products have been granted exemptions that the sales tax now resembles a special consumption or excise tax rather than a broad-

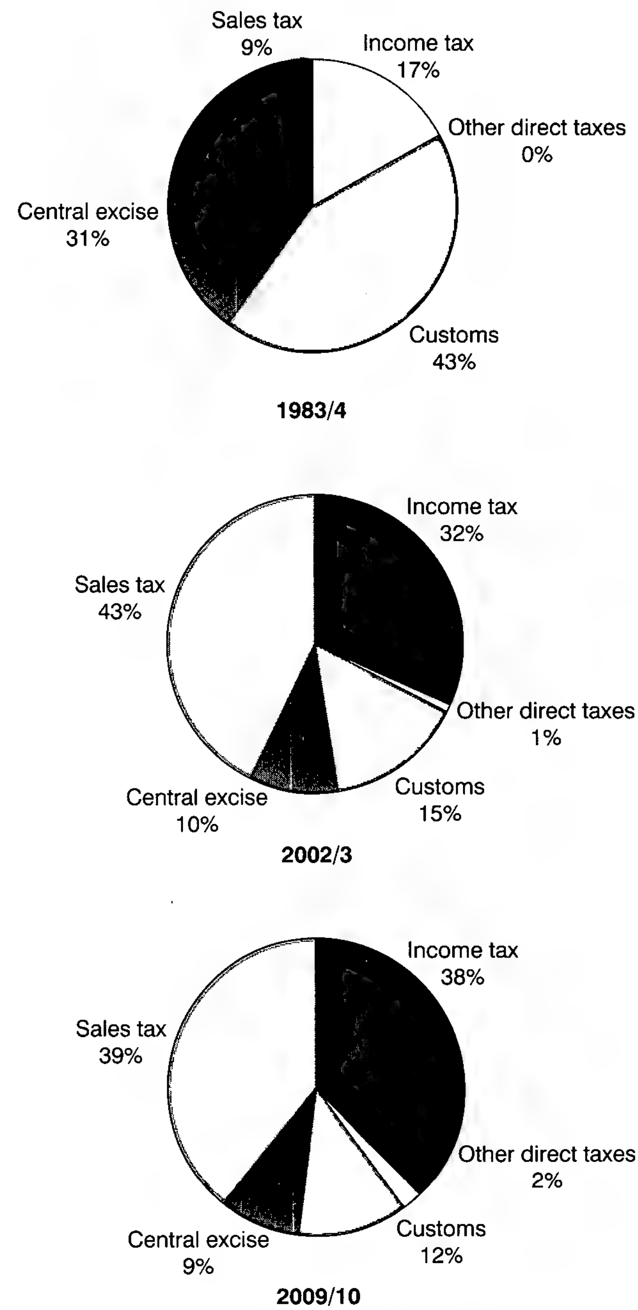


Figure 10.4
Percentage Share of Main Taxes in Total Tax: 1983/4, 2002/3 and 2009/10

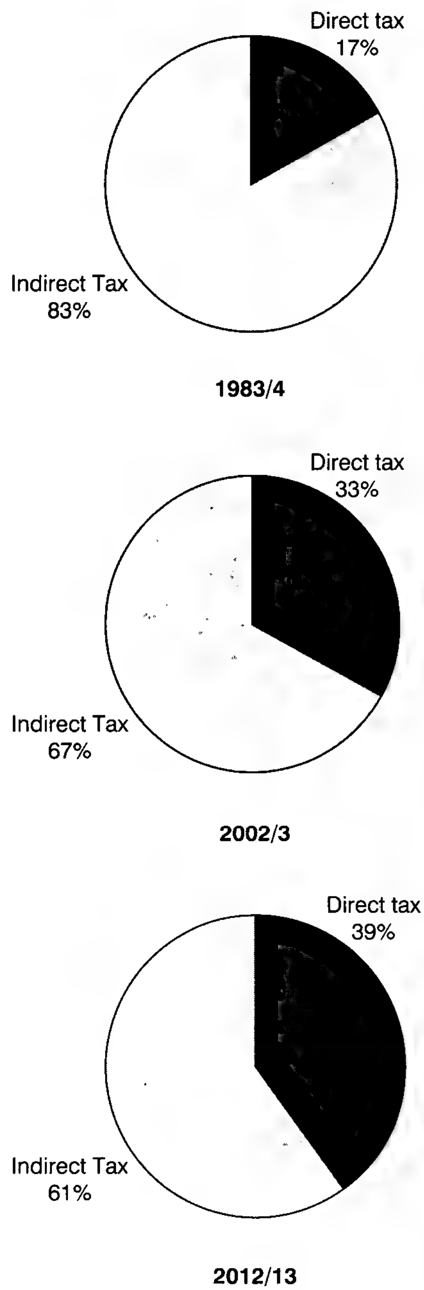


Figure 10.5
Percentage Share of Direct and Indirect Taxes in Total Tax: 1983/4, 2002/3 and 2012/13

> based consumption tax. In addition, differential coverage and differential rates between domestic products and imports (with higher rates for imports) have meant that the tax has 'protective effects' in addition to those generated by the tariff system. In the FY87 budget, the rates for domestic products and imports were made equal, but unequal coverage still leaves some protective effects intact. Cascading of the sales tax through several stages of production has been avoided in Pakistan by making taxes on inputs deductible from taxes on outputs, similar to the procedures under a value-added tax (VAT).
>
> The simplest way, administratively, to develop a broad-based consumption tax would be to expand the coverage of the existing sales tax by drastically curtailing the number of exempted manufactured products. The present sales tax taxes domestic products and imports at the same rate (except for the differential coverage), covers imported goods extensively, and allows taxes paid on inputs to be credited against taxes paid on outputs. Cutting the excessive number of exemptions would serve the objective of increasing the tax burden on domestic consumption.[24]

A key feature of the change in the taxation structure suggested was to cut the excessive number of exemptions under the existing taxation regime, which would then fulfil the objective of increasing the tax burden on consumption. The emphasis was on implementing VAT—a 'manufacturer's level consumption-type VAT'. This shift from a sales tax to a value added tax would require the extension of the coverage of taxation to almost all products at the manufacturers' level and would tax domestic and imported products at the same rate (see Appendices 10.3 and 10.4 in the first edition of *Issues*). This need to establish a Value Added Tax has continued for many years, and lead to a suspension of the 2008 IMF programme—see Box 10.6.

In the Structural Adjustment Programme of 1988, a number of measures regarding the sales tax were undertaken (see Table 10.26). A gradual extension of the coverage of the sales tax on imported and domestically produced goods began. More and more commodities came under the sales tax and items previously exempted were now taxed. The adjustment programme envisaged a fully-fledged general sales tax (GST)—very much like a value added tax—by the end of the programme in 1991. The tax was extended quite substantially from the manufacturer/importer level to wholesalers and retailers for some products. However, the evaluation at the end of the Structural Adjustment Programme revealed that 'the expansion in the tax base . . . remained significantly less than what was initially envisaged, both in terms of the sectoral coverage and the number of taxpayers'.[25] There were many political considerations and constraints which continue to make the GST or VAT a very difficult tax to impose (see also Appendices 10.3 and 10.4). Moreover, Hafiz Pasha identified a number of problems with the large-scale introduction of a full scale VAT in Pakistan. He argued that

> there are some basic problems with the large scale introduction of VAT in Pakistan. First, in the absence of proper accounting and documentation of transactions, especially by smaller manufacturing and trading entities, enforcement of the tax becomes difficult. Also, there appears to be some reluctance on the part of large-scale units to accept tax invoicing of inputs and outputs because of the fear that furnishing of this information will also enable better determination of income

Table 10.18
Level and Composition of Tax Revenues in Developing Countries and in Pakistan (% of GDP)

Tax	Developing countries			Pakistan	
	With per capita income of less than $360	With per capita income of $360 to $750	All	1989/90	1992/3
Direct taxes	**3.91**	**6.84**	**7.26**	**1.83**	**2.71**
Income tax	3.27	5.53	5.11	1.75	2.58
Wealth and property tax	0.24	0.31	0.45	0.08	0.13
Social security taxes	0.21	0.79	1.30	–	–
Others	0.19	0.21	0.40	–	–
Indirect taxes (domestic)	**4.55**	**4.74**	**5.21**	**4.81**	**4.33**
Sales, turnover, VAT	2.44	2.30	2.46	2.17	1.74
Excises	1.55	1.95	2.07	2.64	2.59
Others	0.46	0.49	0.68	–	–
Indirect taxes (foreign)	**5.30**	**7.58**	**5.13**	**5.68**	**4.52**
Import duties	4.05	6.70	4.32	5.11	4.46
Export duties	1.09	0.64	0.62	0.57	0.06
Others	0.16	0.22	0.20	–	–
Others	**0.26**	**0.41**	**0.45**	**0.51**	**0.70**
Total taxes	**14.02**	**19.66**	**18.05**	**12.83**	**12.26**

Sources: Pasha, Hafiz and M. Asif Iqbal, 'Taxation Reforms in Pakistan', *Pakistan Journal of Applied Economics*, vol. 10, nos. 1 and 2, 1994, 50.

Table 10.19
Tax/GDP Ratios of Individual Taxes in Pakistan

Nature of tax	Tax/GDP ratio (%)						
	1960/1	1971/2	1977/8	1987/8	1989/90	2002/03	2011/12
A Direct taxes	1.64	2.30	1.60	1.81	1.85	3.6	3.6
1 Income taxes	1.60	2.20	1.60	1.68	1.70	3.5	3.4
B Indirect taxes	5.50	7.70	9.20	11.80	12.40	7.4	5.6
1 Customs duties	2.20	2.40	4.70	5.50	5.70	1.6	1.1
2 Excise duties	1.40	3.80	3.50	2.50	2.60	1.1	0.6
3 Sales tax	1.84	0.88	1.00	2.00	2.20	4.6	3.9
C Total taxes	7.20	10.00	11.00	13.60	14.30	10.98	9.2

Source: Applied Economies Research Centre (AERC), *Resource Mobilization by Federal Government in Pakistan*, Research Report No. 91 (Karachi: AERC, 1992), 67, and Federal Bureau of Revenue, *FBR Year Book* (Islamabad: various years).

tax liabilities and thereby limit possibilities of evasion. Second, there is a degree of political reluctance to levy GST on the consumption of goods like tea, vegetable ghee, etc. Third, there is a constitutional restriction on the extension of sales taxes to services by the federal government in Pakistan. This implies that the GST cannot be levied on major service inputs like power, gas, transport, etc. and as such it is impossible to make GST correspond to a true value added tax in the absence of an appropriate constitutional amendment.[26]

Nevertheless, as numerous tables have shown in this chapter, import duties have been replaced as the main source of revenue for government by a sales tax now at 16 per cent. Now 42 per cent of government revenue comes from the sales tax, while customs duties provide only 15 per cent.[27]

Direct taxes still form a small part of the total revenue collected by the federal government, and income tax constitutes as much as 95 per cent of direct taxes, yet it suffers from numerous deficiencies. There is a very poor coverage of taxpayers, a narrow tax base is riddled with exceptions and exemptions, and the income tax procedure

Box 10.4

The Elasticity and Buoyancy of Taxes

The elasticity and buoyancy of taxes helps determine how changes in the economy will impact on revenue.

The measure of *elasticity* of a tax system gives the automatic or natural responsiveness of tax yields to changes in national income. It is defined as a percentage change in total yield (or yields of individual taxes) associated with a given percentage change in GDP (or the relevant GDP component) without any change in the statutory rate of existing tax(es), in administrative efficiency or due to the introduction of new taxes.

Buoyancy measures the total response of revenue from a tax or taxes due to a change in income. It shows the growth that results from automatic growth of the base caused by the increase in GDP and from discretionary tax changes. The buoyancy of a tax system or individual tax is usually greater than or equal to the elasticity because tax rates are usually increased over time.

The magnitude of the elasticity depends on the level of tax rates, the progressivity of the rate structure, whether tax rates are specific or *ad valorem* in character and the change in the tax base due to changes in income. For the purpose of analysis, it is usually possible to break up the coefficient of elasticity into tax-to-base and base-to-income components. The first gives the responsiveness of tax yield to a change in tax base and the latter encompasses the effect of changes in base due to change in income.

The value of the tax-to-base elasticity depends on tax rates and the progressivity of the tax structure. If the rate structure is progressive or if there is an improvement in tax administration then the tax-to-base elasticity is likely to be high, thereby implying a higher overall elasticity. However, if high marginal tax rates induce higher evasion and corruption in tax payment then the tax-to-base elasticity is likely to be lower. Alternatively, if tax rates are specific rather than *ad valorem* then revenues may not rise proportionately with the increase in tax base and the elasticity in this case would be less than unity.

The base-to-income elasticity primarily depends upon the nature of the relationship between changes in income and changes in the tax base. This elasticity can be assumed to be largely exogenous and beyond the control of the tax collecting agency. In contrast to this, the magnitude of the tax-to-base elasticity can be influenced by policy action.

The elasticity of the entire tax system at any particular time is the weighted sum of the elasticities of the individual taxes, with the weights corresponding to the revenue shares. If the share of elastic taxes is higher, then the overall tax system will be more elastic.

Source: Applied Economics Research Centre (AERC), *Resource Mobilization by Provincial and Local Governments in Pakistan*, Research Report No. 93 (Karachi: AERC, 1992), 56–8.

Table 10.20
Elasticity and Buoyancy of Major Taxes w.r.t. Income (GDP)

Federal taxes		Coefficient 1972/3 to 1989/90	1972/3 to 1980/1	1981/2 to 1989/90
Custom duty	Elasticity	0.692	0.943	0.696
	Buoyancy	1.063	1.177	1.065
Excise duty	Elasticity	0.658	0.916	0.526
	Buoyancy	0.894	1.148	0.532
Sales tax	Elasticity	1.010	1.082	1.446
	Buoyancy	1.259	1.256	1.713
Income tax	Elasticity	0.946	1.377	0.294
	Buoyancy	1.098	1.347	0.643
Total tax	Elasticity	0.800	1.064	0.800
	Buoyancy	1.070	1.206	0.983

Source: Applied Economics Research Centre (AERC), *Resource Mobilization by Federal Government in Pakistan*, Research Report No. 91 (Karachi: AERC, 1992), 67.

is badly integrated with company law. The large number of exemptions have 'traditionally been justified as incentives for investment, saving, exports, regional development, etc.'.[28] Only 3 million income taxpayers in a population of 180 million exemplifies the extent of tax evasion in the country, and according to one observer, as many as three-quarters of potential taxpayers in Pakistan do not pay taxes.[29] According to another estimate, it is estimated that the evasion of income tax is almost five times the collected amount.[30] Hence, the 'collection of income tax has remained restricted largely to the industrial and financial sectors, to public limited companies and multinationals, to corporate profits and salary income and to the metropolitan cities of Pakistan'.[31] Also see Box 10.2 and Box 10.6, and Appendix 10.3 on the income tax.

To be able to have a more broad-based income tax, it would be necessary to have proper documentation of the economy and to do away with the numerous exemptions, as well as to streamline the taxation structure so as to make it easier to catch tax offenders. However, given the fact that the tax administration is highly corrupt and often in collusion with tax evaders, even if an effective income tax structure were imposed, it is likely that the real culprits would be able to get away, and only the smaller offenders would be caught, as is often the case. Nevertheless, the reform of tax administration, irrespective of cultural and structural problems such as pervasive and excessive corruption, is a minimum condition that must be fulfilled if any worthwhile

Table 10.21
Decomposition of Buoyancy of Major Taxes

Federal taxes	Tax base	1972/3 to 1989/90			1972/3 to 1980/81			1981/2 to 1989/90		
		Tax to tax base buoyancy	Tax base to income buoyancy	Tax to income buoyancy	Tax to tax base buoyancy	Tax base to income buoyancy	Tax to income buoyancy	Tax to tax base buoyancy	Tax base to income buoyancy	Tax to income buoyancy
Import duty	Value of imports	1.002	1.061	1.063	0.920	1.271	1.177	1.208	0.881	1.065
Excise duty	Value added in large-scale manufacturing	0.776	1.152	0.894	0.675	1.701	1.148	0.563	0.945	0.532
Sales tax	Value of imports + Value of industrial production + Custom duty	1.203	1.047	1.259	1.188	1.057	1.256	1.561	1.097	1.173
Income tax	Non-agriculture GDP	1.024	1.072	1.098	1.260	1.069	1.347	0.596	1.079	0.643

Source: Applied Economics Research Centre (AERC), *Resource Mobilization by Federal Government in Pakistan,* Research Report No. 91 (Karachi: AERC, 1992), 67.

Table 10.22
Key Financial Ratios of the Provinces: 1990–1995

Year	As percentage of recurring expenditure			As percentage of total expenditure[a]		
	Federal tax assignment[b]	Provincial own revenue	Revenue surplus/ deficit	Debt servicing	Development expenditures	Total federal transfer[c]
Punjab						
1990/1	59.5	25.7	–6.3	25.3	24.8	75.9
1991/2	77.8	23.8	4.7	24.9	23.5	81.8
1994/5	89.7	17.8	7.6	22.0	18.7	87.4
Sindh						
1990/1	48.6	20.6	–20.7	21.7	28.1	65.5
1991/2	78.4	19.0	1.1	24.1	23.5	87.1
1994/5	79.7	15.9	2.3	21.5	29.9	99.0
NWFP						
1990/1	41.8	11.6	–0.7	28.4	27.2	93.7
1991/2	97.6	10.2	11.0	30.8	33.6	87.6
1994/5	99.2	10.3	9.6	28.8	28.8	90.5
Balochistan						
1990/1	49.5	6.3	–15.5	23.5	33.9	85.5
1991/2	119.8	4.8	26.5	22.0	39.5	96.5
1994/5	112.5	5.4	18.1	20.5	33.0	96.6
Four combined						
1990/1	53.0	20.5	–9.9	24.7	26.9	77.0
1991/2	84.9	18.6	6.7	25.4	27.1	85.7
1994/5	90.6	15.0	7.4	22.9	25.0	92.4

[a]Total expenditure = Development expenditure + Current expenditure.
[b]Including profit from hydro-electricity.
[c]Federal transfer = Federal tax assignment + Development grants + Federal loans + Development revenue receipts.
Source: Ghaus, Rafia and Abdul Rauf Khan, 'Fiscal Status of the Provincial Government in Pakistan', *News on Friday,* 25 August 1993.

Table 10.23
Share of Different Levels of Government in Expenditure on Social Sectors in Pakistan: 1990/91[a] (%)

	Federal	Provincial	Local
Education and training	13	83	4
Health and nutrition	16	62	22
Population welfare	97	3	0
Social welfare	73	27	0
Physical planning and housing[b]	5	50	45
Manpower and employment	74	26	0
Others	37	32	31
Total	20	64	16

[a] Latest year for which local government figures are available.
[b] Mostly water supply and sanitation.
Source: Hanif, Naveed, 'The Structure of Government in Pakistan', *News on Friday*, 25 August 1996.

measures towards better tax effort and resource mobilization are to take place (see Appendix 10.4 and 10.5). At the same time, it is important to emphasize that there are numerous vested interests in maintaining the status quo who may be unwilling to permit any sort of change (see Boxes 10.5 to 10.7).

10.4.2 Resource Mobilization at the Provincial Level

Prior to the changes initiated in the 18th Amendment and through the 7th NFC Award which will have an impact on resource mobilization, almost 90 per cent of revenue was collected at the federal level and the remaining 10 per cent distributed between the two lower tiers of government, yet the role that both provincial and local governments played in the delivery of services prior to the 18th Amendment was often critical. Social services, in particular, such as education, health, and water supply and sanitation, were provided by provincial and local governments, hence the need to examine issues particular to resource mobilization (see Table 10.23). After the 18th Amendment, that role of provincial government has been much enhanced, and due to the 7th National Finance Commission Award of 2009/10, so have the financial resources available to the provinces.

Provincial governments had access to resources from a divisible pool of federal taxes for their recurring account, as per the prescribed formula of the earlier National Finance Commission awards. In that award, 37.5 per cent of revenues of the federal government income tax, export duty on cotton, excise duty on tobacco, and the sales tax were given to the provincial governments on the basis of their population share. Prior to the 1991 NFC award, the federal government used to fulfil the deficit financing component of the provincial governments in the form of grants-in-aid or loans. At their peak, in 1987/8, these grants were worth Rs. 17 billion or 2 per cent of GDP. However, the 1991 Award stopped such payments from the federal government to the provincial governments, and there was greater pressure on the provincial governments to put their house in order and to self-finance their revenue deficits.

Aisha Ghaus and Asif Iqbal identified the following problems in the provincial resource mobilization structure which existed prior to 2010, although similarities still exist post-2010.

1 Limited scope of resource mobilization as the large and relatively buoyant taxes, such as import duties, income and corporate tax, excise duties and sales tax, have been 'pre-empted by the federal government. The taking over of the sales tax, in particular, by the federation soon after partition has been cited as a major encroachment on provincial fiscal power.'[32]
2 The Islamization process has caused loss of revenue from provincial excises, entertainment tax and land revenue.
3 Provincial governments have not been able to exploit the agricultural income tax, tax on value added in the services sector and capital gains on immovable properties.

Table 10.24
Annual Compound Growth Rate in Tax Revenue by Province: 1990/1 to 1994/5 (%)

Tax	Punjab	Sindh	NWFP	Balochistan	Pakistan
Stamp duty	0.1	23.9	25.1	10.0	7.5
Urban immovable property tax	15.5	–	7.0	12.2	33.0
Tax on transfer of property	–2.6	19.6	7.5	21.5	6.1
Land revenue	17.6	13.3	3.9	28.2	16.3
Tax on professions, trades, and callings	11.4	21.3	–	0.0	18.1
Provincial excise	28.7	14.3	7.5	179.1	19.5
Motor vehicle tax	13.0	15.5	7.1	0.0	12.2
Entertainment tax	2.3	–7.8	0.0	2.6	0.3
Cotton fees	–0.1	4.9	–	–	0.5
Hotel tax	19.1	47.0	9.8	–	34.1
Electricity duty	–12.3	80.7	20.9	10.8	0.0
Other taxes	–6.0	37.2	–10.0	–	22.4
Total	3.8	23.8	13.9	6.3	9.5

Source: Ghaus, Rafia and Abdul Rauf Khan, 'Fiscal Status of the Provincial Governments in Pakistan', *News on Friday*, 25 August 1993.

Table 10.25: Total Revenue and Taxes: 1961–2011

Year	Total Revenue	Tax Revenue	Direct Taxes	Indirect Taxes
	-------- As Percentage of GDP at Factor Cost --------			
1961–62	11.85	8.78	1.97	6.81
1962–63	9.80	8.05	1.34	6.71
1963–64	12.12	8.04	1.33	6.72
1964–65	12.37	9.01	1.28	6.98
1965–66	12.89	8.64	0.95	7.69
1966–67	13.46	9.84	0.99	8.85
1967–68	12.98	9.26	0.74	8.52
1968–69	14.95	10.88	0.84	10.04
1969–70	15.19	10.93	1.10	9.84
1970–71	12.93	9.12	0.48	8.64
1971–72	12.04	8.57	1.66	6.92
1972–73	12.12	9.48	1.23	8.25
1973–74	13.39	10.35	0.96	9.38
1974–75	12.43	9.60	0.91	8.69
1975–76	12.60	9.45	0.66	8.79
1976–77	12.96	9.68	0.61	9.78
1977–78	13.75	9.97	0.43	10.30
1978–79	14.28	10.35	0.44	10.63
1979–80	18.23	15.72	2.61	13.12
1980–81	18.70	14.73	2.90	11.83
1981–82	17.42	13.67	2.89	10.78
1982–83	18.02	15.66	2.82	12.84
1983–84	19.31	15.59	2.46	13.13
1984–85	18.21	14.40	2.29	12.11
1985–86	19.27	15.53	2.20	13.33
1986–87	20.15	16.09	2.15	13.93
1987–88	19.47	15.55	2.07	13.48
1988–89	20.36	16.15	2.14	14.02
1989–90	20.60	16.14	2.26	13.88
1990–91	19.83	15.57	2.19	13.38
1991–92	21.60	15.33	2.78	12.55
1992–93	20.24	14.97	3.17	11.80
1993–94	19.47	14.88	3.18	11.69
1994–95	19.31	15.42	3.78	11.65
1995–96	19.70	15.83	4.15	11.69
1996–97	17.26	14.58	3.91	10.67
1997–98	17.60	14.58	4.24	6.10
1998–99	17.13	14.28	3.86	10.42
1999–00	14.39	11.39	3.25	8.14
2000–01	14.10	11.26	3.28	8.05
2001–02	15.05	11.56	3.56	8.01
2002–03	15.90	12.26	3.48	8.74
2003–04	15.07	11.59	3.24	8.38
2004–05	14.70	10.77	3.15	7.62
2005–06	15.04	11.23	3.22	8.32
2006–07	15.76	10.80	4.10	6.70
2007–08	15.11	10.59	3.94	6.65
2008–09	15.28	9.95	3.67	6.97
2009–10	14.77	10.66	3.80	6.86
2010–11	13.21	9.98	3.54	6.61

Source: This table has been provided by Fahd Ali.

4 The elasticity of provincial taxes is low, which means low growth in tax revenue.

5 'The incentive environment prevalent in the country has not been conducive to greater fiscal effort by the provinces. Automatic access to ad hoc revenue deficit grants provided an opportunity to the provincial governments to declare higher revenue deficits (by lowering own revenue effort and by raising expenditure) and thereby receiving a higher grant from the federal government.'[33]

6 Poor tax administrators.

With pressure on them, surprisingly, provincial governments tried to deal with having to raise revenue and meet their deficit requirements. The provinces, since the 1991 NFC award, 'adopted a diversified resource mobilization strategy focusing on most of the existing taxes like stamp duties, property tax, motor vehicle tax, hotel tax, tax on professions, trading and callings, electricity duty, paddy development fee, cotton fee and land revenue'.[34] This was done by removing exemptions and by expanding the tax net. Those tax rates which were very low were enhanced, such as stamp duties, motor vehicle tax, paddy fees, cotton duty, and electricity duty. Also, there was a switch from specific to ad valorem taxes. The consequence of these measures had been a considerable increase in the growth rate in provincial tax revenues between 1990 and 1995, especially in Sindh and the NWFP (see Table 10.23).

Aisha Ghaus and Asif Iqbal conclude their evaluation of the substantial changes in the provincial governments' resource mobilization strategy since the 1991 NFC award on a positive note. Although they add that these reforms constitute only a 'small step in the right direction' and much more needs to be done, their overall analysis was as follows:

> On the whole, it appears that the tax reforms introduced by the provincial governments in the last few years will broaden somewhat that provincial tax base, introduce an element of buoyancy in tax revenues and reduce revenue leakages. On top of this, given the nature of provincial taxes like stamp duties, property tax, etc. with a heavy concentration on physical and financial assets the incremental burden of most of the reforms is likely to be on the upper income groups and, therefore, the reforms will increase the progressivity of the provincial tax system. Also, the reforms are unlikely to have had a significant impact on the price level of basic goods.[35]

These efforts at reform and improvement notwithstanding, there were numerous problems and issues regarding provincial resource mobilization measures which had not been addressed and even after post-2010, continue to persist. The urban immovable property tax was a case in point.

This tax is dependent and based on the gross annual rental values (GARVs) of properties, with assessment by the provincial governments due every five years. None of the provincial governments regularly revised its assessment every five years, and the last actual assessment in the province of

Table 10.26
Taxation and Expenditure Proposals according to the Structural Adjustment Programmes: 1988–1991 and 1993–1996

Policy areas	Objectives and targets	Strategies and measures
Structural Adjustment Programme, 1988–1991		
Overall deficit	Achieve a reduction in the overall fiscal deficit/ GDP ratio to 4.8 per cent by the end of the programme period; reduce budget's dependence on private savings and domestic bank borrowing.	Major improvements in overall revenue performance and tight control of expenditure growth.
Revenue	Foster domestic resource mobilization in order to achieve a sustainable level of development and essential current expenditures aimed at maintaining high economic growth in the context of economic and financial stability. Achieve an increase in the revenue/GDP ratio to about 20 per cent by the end of the programme period.	Begin to implement a tax reform directed at expanding the tax base and at increasing tax elasticity; continue the strengthening of tax administration. Extension of sales tax on about 22 per cent of domestic industrial production. Extension of sales tax on 30 per cent of domestic industrial production. Increases in telephone charges. Extension of ad valorem excise on certain services such as travel. Annual revision in those excises which are at specific rates so that there is revenue elasticity. Initiate a programme of action to prepare for the introduction of a general sales tax (GST) by 1 July 1990. Proceed with the implementation programme of action. Effective implementation of the general sales tax. Guidelines issued to income tax panels to set criteria for initiating prosecution against tax evaders. Maintain income and profit tax exemption limits at current levels. Review experience of self-assessment procedure for taxpayers earning less than Rs. 100,000. Removal of most exemptions from the standard customs 1989/9 duties, except for duty drawbacks for exports and incentives for industries as given in the 1988/9 budget. It is the authorities' intention that these exemptions will not be extended beyond 1990/1, except for backward areas as defined in the 1988/9 budget. Continue implementation of tax reform.
Structural Adjustment Programme, 1993–1996		
Budget	Improve structure of the budget and revenue elasticity.	In GST following measures are to be implemented by 1 July 1994: Removal of exemptions for mostly locally produced goods and imports (except basic foodstuff, medicines, fertilizers, and pesticides). Elimination of capacity scheme within the framework of GST. Introduction of turnover threshold for registration as taxpayer. All specific rates and assessments based on official prices and lower rates for manufacturers that do not claim tax credit to be eliminated. Evaluation of VAT to firms in trading and services sector by 1 July 1994. Excise regime will be rationalized.
Direct taxes	Reduce the wide-ranging exemptions and concessions. Extend coverage to agricultural sector 1993/4; further expand the base 1994/5. Simplify the rate structure for direct taxation. Contain basic personal exemptions and provisions concerning employee benefits. Unification of corporate profit tax rate. Reduction of tax holiday provisions. Transfer the current presumptive tax provisions relating to supplies, contract, imports, and exports into an advance payment for regular income tax.	
Indirect taxes	Reduce maximum tariffs. Import licence fee requirement to be eliminated by 30 June 1994. Eliminate export taxes by 30 June 1994. Conversion of GST into modern broad-based VAT through significant expansion in the number of registered taxpayers, extension of horizontal and vertical coverage, and removal of exemptions.	

Sources: World Bank, *Pakistan: Medium-term Economic Policy Adjustments,* Report No. 7591-Pak (Washington DC: World Bank, 1989), 159; Karachi Chamber of Commerce and Industry, *Proceedings of a Seminar on Reducing Fiscal Deficit – Key to Salvage Economy* (Karachi: CCI, 1994), 41.

Box 10.5

Vested Interests and the Taxation Structure

Hafiz Pasha argues that the taxation structure needs to be seen in the context of different interest groups active in the economy. He writes:

> Behind each major tax exemption or concession there is a strong, entrenched vested interest group in Pakistan. Each group has organized itself as an effective lobbying entity, which has not only blatantly demonstrated its power in political terms, but in more subtle terms also has played the game of patronage seeking through party donations, supporting influential politicians, etc. and developed credible arguments for the retention of these exemptions and fiscal incentives in the greater national interest.
>
> Perhaps the best example of this is the agricultural lobby. It is extremely well organized and enjoys enormous political power. Over 80 per cent of the elected members of the parliament either represent the feudal class or are sympathetic to the interests of this group. It is not surprising, therefore, that any legislation to change the status quo is effectively blocked. A number of arguments have also been developed to justify the exemption of agricultural income tax [including] the fact that the sector is already 'overtaxed' through the pricing mechanism (domestic prices below world prices), that food production is vital for national security and that the high costs of collection of the tax on agricultural income will not be justified because of the likely low revenue yield [see also Chapter 5].
>
> Tax holidays have been aggressively supported by industrial interests who have formed an alliance with the provincial governments of backward areas. They have been successful in playing up the sensitive issue of large and widening regional disparities in the country. The Ministry of Finance (a key agent of the state itself) has justified the exemption of interest income on government savings instruments on the ground that this actually improves the income distribution because the bulk of participation in such savings schemes is by lower and middle income households, and that this incentive reduces the need to resort to inflationary mechanisms for financing the budget deficit.
>
> The need for retention of the capital gains on financial assets has been successfully argued by representatives of stock exchanges in the country. Various associations of members of stock exchanges have portrayed the share market as a barometer of the performance of the government and the economy. They have stressed the need for fiscal incentives to attract foreign private portfolio investment and thereby improve the balance of payments position, and so on.
>
> Altogether, tax reform involving broad-basing of direct taxes through the removal of major exemptions and concessions has been effectively frustrated by entrenched, powerful, well-organized and articulate interest groups. The government has had to retreat in the face of opposition from such groups. It has been left with the worst possible outcome. Tax rates have come down, while the multitude of tax expenditures continues.
>
> The failure of government to broaden the base of direct taxes by reducing tax expenditures leads to the identification of a number of factors which mitigate against success of reform initiatives as follows:
>
> **i)** Lack of commitment to the reform by agents of the state, arising from a perception that the reform may damage vital national interests like food production, savings, exports, etc.
> **ii)** 'State capture' by special interest groups like the traditional feudal élite, bureaucracy and the emerging corporate business interests which extract substantial rent from the existing tax–expenditure system and are unwilling to give up their privileges.
> **iii)** Wrong strategy of implementation of reforms. By first reducing tax rates the opportunity which existed for bargaining with (and compensating) losers was lost.

Source: Pasha, Hafiz, 'Political Economy of Tax Reforms: The Pakistan Experience', *Pakistan Journal of Applied Economics*, vol. II, nos. 1 and 2, 1995, 143–4.

Sindh was made fifty years ago, in 1968! There can be no denying the fact that there is a very strong case for immediate reassessment of the rental value of properties in urban areas.

According to a report:

> The case, therefore, for a more or less immediate reassessment of GARVs is very strong. The longer this process continues to be delayed on the grounds of political expediency or otherwise, the less will be the degree of exploitation of the revenue potential of this tax. This is of particular significance to the local governments in the country who generally get the dominant share of revenues collected. Municipal revenues have tended to be constrained by the low level of revenues from the property tax which is internationally one of the principal sources of local revenue.[36]

This particular tax, which has always had immense potential as far as revenue from provincial governments was concerned, is one of the most underdeveloped sources of revenue for the provincial governments. Moreover, since most of the revenue from this tax (85 to 95 per cent in the past) was given to the local governments at the lower tier, the underdevelopment of this tax and low effort on the part of provincial governments had a serious negative impact at the local level as well. The constraint on developing and expanding this tax on the basis of new assessments and at enhanced rates has always been political. Although the Ordinances require reassessment of property value every five

Box 10.6

Waivers and Exemptions, and the Culture of SROs

1. Khurram Hussain, shows one of the many unsavoury sides of Pakistan's taxation structure, where numerous industries, firms and individuals have been granted waivers and exemptions and do not have to pay taxes.

If you like big numbers, you'll love this. On Monday our finance minister told us all that more than Rs. 650 billion worth of tax exemptions have been granted to various entities over the last four years.

To get some perspective on the scale of that number consider this: the total amount of money that Pakistan has received from the IMF over the same time period is a little over \$5bn, which converts to less than Rs. 500bn, for now anyway.

Get it? The amount that has been given away through exemptions and waivers on taxes to a whole galaxy of domestic stakeholders is larger than the amount that Pakistan has sought as a bailout from foreign creditors over the last four years.

Quietly and rather matter of factly, our finance minister has informed us that we go around the world asking for aid in all shapes and varieties, and this is what we essentially do with the aid money when it arrives. We give it away to large stakeholders in the form of waivers and exemptions on taxes.

The math gets truly infernal. Just annualise the amount given to us by the IMF, for instance, and you get a figure of about Rs. 125bn per year as the amount we've received from the facility that began in November 2008.

And if you look at the revenue amounts waived during the same years, they average out to above Rs. 150bn each year, meaning that our own revenues are being used to cover the revenue loss from these waivers and exemptions after all aid money has been consumed.

I could cut this any number of ways and it gets worse and worse. Not only are we asking foreign creditors to help us pay for these exemptions and waivers, we're leaning on the generosity and philanthropic instincts of our friends and allies, we're invoking the blood and sacrifice of our war dead, we're parading the plight of our flood victims on the world stage to buttress our demands.

And all the while, the waivers and exemptions have continued unabated. In the year of the great flood, to take one example, while the country went to every forum in the world to ask for financial assistance in the name of the flood victims, while the government hosted a donors' conference of sorts in the comfort of the Serena Hotel in Islamabad, the total amount given away through waivers and exemptions was just over Rs. 150bn, larger than the amount of money we got in aid in the name of the floods.

There are four separate categories under which these waivers and exemptions are typically granted. The Customs Act of 1969, and the respective statutes that govern the operation of the sales tax, income tax and federal excise duties. Each statute contains specific clauses that give the power to grant exemptions.

'There are two types of waive-offs,' the finance minister's statement says. There are those which are 'claimed by the taxpayers at the time of filing tax returns' and those that are allowed by the government 'any time during the year keeping in view the economic realities'. The latter variety of exemptions are granted through what are known as a statutory regulatory order, or SRO, and other miscellaneous notifications that the tax bureaucracy is empowered to issue on its own.

And only a day after the finance minister's statement before the National Assembly, the Public Accounts Committee was informed that more than 4,500 SROs have been granted in the last four years. 'It seems the country is running on the SROs,' the committee's chairman reportedly said upon hearing this.

This power to grant waivers and exemptions is not new, nor is this the only government to have used it so widely. In fact, it's decades old, with some of the legislation dating back to 1969, and the last modifications to the statutory authority of the tax bureaucracy to grant waivers and exemptions having been made in 2001.

Every government for as far as our memory is allowed to travel has used these powers extensively to play a complex game of give and take with the country's business elite.

Sometimes this complex game of give and take has operated through minor adjustments to the administered prices, like in the case of sugar, and other times through legislation that skews the pitch in favour of one player or category of players, like in the refusal to impose a proper capital gains tax on stock brokers.

But fine-tuning of this game, this political economy of the rentier state, works through the ad hoc grants of waiver and exemptions that are often designed for the benefit of a single party.

The finance minister's statement is accompanied by a list of those entities that have availed of a waiver of customs duty larger than Rs. 1 million, and the list contains names of NGOs, lots of government departments, as well as private companies.

But the real list we need to see is the one that contains names of parties that have had amounts waived under the sales tax, where the large trade-offs are applied.

Unfortunately, the minister's statement says that such a list is 'not maintained by the FBR/field formations'.

This is the real reason behind the failure to bring about a value-added tax in this country, in spite of efforts for over a decade. VAT shuts down this power to issue SROs and grant waivers and exemptions, and as a result closes the back door through which successive governments have gamed their fortunes.

Closing down this window of opportunity, if one may play with a metaphor, is critical to placing the country on a sustainable footing, to ending our constant search for a walk-on role in a great powers war.

Source: Husain, Khurram, 'Of Waivers and Exemptions', *Dawn*, Karachi, 13 December 2012.

2. Mubarak Zeb Khan, shows how Pakistan's elite benefit from exemptions of duties.

Almost 84 per cent of tariff and duty rates have either been exempted or reduced for the benefit of certain influential lobbies and the elite in the country through notorious statutory regulatory orders (SROs) issued by the present government.

The startling revelation was made by Federal Board of Revenue Chairman Ali Arshad Hakeem at a meeting of the Senate standing committee on finance held here on Thursday. 'This is a 'financial NRO' in the form of SROs for the elite,' he said. The meeting was convened to discuss the tax amnesty bill.

When Senator Ishaq Dar of the PML-N termed the bill a 'financial NRO', the FBR chief pointed out that certain influential lobbies and the elite were already enjoying these exemptions and concessions. Defending the amnesty scheme, Mr Hakeem said exemptions in income tax, customs duties and general sales tax had created anomalies in the tax system and could be called financial NRO. 'We will approach the finance minister next week to remove these anomalies and enact a fair and equitable taxation system for all.'

He said there was a permanent window available for whitening money under section 111(4) of the Income Tax Ordinance. No questions were asked about foreign remittances, he said, adding that it provided an easy way to tax evaders for whitening black money. Mr Hakeem said there was no economic justification for concessions because favours were mostly given to friends, political cronies and powerful inefficient producers. 'We will soon work out the financial impact of these favours in duty and taxes given to influential people.'

Senator Nasreen Jalil, chairperson of the committee, put a number of questions to the FBR team and said the amnesty bill had many controversial clauses which needed clarification from the FBR. Ishaq Dar was of the opinion that the committee should reject the proposed bill in totality. After some arguments by the FBR team and suggestions, mostly from Mr Dar, the committee decided to hold another meeting, probably on 4 January for making recommendations on the bill before sending it the Senate for approval.

Noting that the bill in its existing shape could be challenged in court, Mr Dar suggested to the FBR to bring the specific amnesty scheme with the bill for approval at the next meeting. He was of the opinion that parliament could not give power to any institution to bring such schemes at the name of national interest. Senator Hamayun Khan Mandokhel also said parliament could not give blanket power to the FBR, adding that the present bill was not clear and needed further clarification. Senator Haji Adeel of the ANP asked the FBR why notices had not been issued to tax evaders.

The FBR chairman said he feared that data would be misused by tax officials who would get kickbacks from the identified tax evaders instead of collecting revenue for the government. 'The data collected by Nadra is a 'gold mine' and it needs to be used efficiently and carefully,' he said.

The FBR chairman said he still believed that tax officials would harass taxpayers, despite the fact that salary and perks of officials had been doubled over the past few years. 'We want to bring all 3.8 million people into the tax net in an honourable way,' he said.

Mr Hakeem said that 2.9 million tax evaders had been identified with the help of Nadra. Of these, 2.2 million are non-national tax number (NTN) holders and 0.7 million NTN holders, but non-filers/evaders. He said 200,000 tax evaders were rich people who did not even exist on the tax roll. 'We will issue notices to them in the next few days,' the FBR chairman said and clarified that the proposed amnesty schemes would not apply to them.

The FBR chairman said that because of capacity constraint, the remaining 2.7 million people would be given an option to come under the tax net by paying Rs. 40,000 on declaring their hidden income/assets of up to Rs. 5 million. They will have to pay Rs. 50,000 in the second month and Rs. 70,000 in the third month to avail the facility.

If the amount of undeclared income/assets/expenditures exceeds Rs. 5 million, tax rate for the declared value will be one per cent in the first month of the scheme, 1.25 per cent in the second month and 1.75 per cent in the third month. The FBR chairman said the existing taxpayers who disclosed their undeclared income/assets of up to Rs. 5 million would pay a token money of Rs. 100. No question about the source of undisclosed income/assets/expenditure would be asked, he added.

Khan, Mubarak Zeb, 'Elite got 84 pc tariff, duties exempted or reduced: FBR chief', *Dawn*, Karachi, 29 December 2012. The article has been slightly edited.

3. Shahid Kardar, writes about how SROs have destroyed Pakistan's tax culture.

THE Public Accounts Committee (PAC), and especially its chairman Nadeem Afzal Gondal and member Zahid Hamid, deserve to be applauded for taking up the issue of the notorious instrument called the SRO (Statutory Regulatory Order) and for articulating the need to end the practice of the executive issuing SROs. The latter make a complete mockery of the tax structure approved by parliament through the finance bill tabled with the budgetary proposals for the year.

Seemingly unbeknown to parliament and the public at large the government of the day can, through this notorious SRO, grant favours to friends, political cronies and powerful specific groups/lobbies of inefficient producers through concessions in income tax, customs duties and GST (general sales tax).

The Federal Board of Revenue's notifications through these SROs nullify the provisions of the finance bill approved by parliament, which under our constitution is the ultimate repository of such powers. It is indeed revealing that the cost of such tax waivers and exemptions is in excess of Rs. 150 billion a year, and then we lament that our tax-to-GDP ratio is amongst the lowest in the world!

For illustration take the case of customs duties. We find that as against the effectively traded 5,000 tariff lines there are SROs covering 84 per cent of them—impacting 45 per cent of imports and encompassing almost all sub-sectors, rendering the actual tariff different from the standard tariff.

This has resulted in the customs tariff having multiple rates, several exemptions and several conditions' requirement fulfilment, providing opportunities for the discretionary use of powers by officials, raising the cost of doing business and incentivising malpractices, corruption and misdeclaration for evading duties.

The power of the administrative apparatus to issue SROs has, therefore, provided money-making opportunities for those empowered to approve such exemptions.

These arrangements under the cover of the reprehensible practice of issuing SROs represent a cosy pact between the well-connected and the bureaucracy or the political masters in power. The abuse of such discretionary powers has enabled inefficient producers to thrive at the expense of us unfortunate, hapless consumers who pay a heavy price for keeping afloat producers who are not competitive internationally.

Their preferential treatment enables the beneficiaries to 'extract rents' and make easy money without having to make the effort to produce and market competitively a good quality product. Many a rags-to-riches story can be traced to this ubiquitous instrument, which has made large chunks of the manufacturing sector addicted to high levels of protection.

Moreover, in this way neither those favoured nor those favouring them are accountable to parliament for striking such bargains. Tragically, even the courts have, through a host of decisions, protected those benefiting from SROs. And the cost to the economy of this protection has also been huge in terms of scarce resources being tied up in the inefficient production of goods.

Investors are understandably shy of operating in an environment muddied by such concessions, which has resulted in the shifting of the goal posts in favour of the chosen few who acquire a monopolistic status or are in a position to form cartels. Consequently, the policy and supporting tax structure incentivises investments in speculative ventures rather than longer gestation projects of greater importance to the economy.

By abdicating its power and allowing the executive to arrogate to itself the power to give such dispensations not only has parliament been a party to rendering meaningless the sanctity of the federal budget and the finance bill that it has itself passed, it has been an accomplice to acts that are ultra vires to the country's constitution.

Apparently, the power of the executive flows from an old 1969 act under which it was delegated such powers by parliament. The PAC having taken the lead to change the narrative should demand that this act be repealed, to take away all such powers of the executive in the future, restoring them rightfully to parliament. This would be consistent with international best practices, the world having discontinued with such a practice.

Of course, nonsensical arguments will be made about the possible loss of revenues and the need to facilitate governments to take quick decisions in emergency situations. And that depriving the executive of such flexibility would hamper governmental operations in a rapidly changing global environment.

In this writer's view, conditions could be drafted under which prior parliamentary permission would not be required, although its approval would have to be obtained within 90 days.

As for the argument on loss of revenues it is instructive that because of these SROs that its proponents would seek to retain, approximately 2,000 tariff lines (representing 50 per cent of the SROs) are liable for import duties of less than 5.1 per cent, with almost 900 of them zero-rated! So much for the likely claims about the potential loss of revenue.

As regards SROs issued to date there should be a comprehensive review of each SRO with its retention being contingent on parliamentary ratification (through incorporation in a finance bill), otherwise there should be an action plan for its gradual phasing out.

http://dawn.com/2012/12/25/the-curse-of-sros/

Kardar, Shahid, 'The curse of SROs', *Dawn*, Karachi, 25 December 2012. http://www.brecorder.com/taxation/181:pakistan/1273827:sros-a-kind-of-financial-nro-fbr-chief/?date=2012-12-29

SROs a kind of financial NRO: FBR chief

The Chairman of the Federal Bureau of Revenue, stated that the SROs which abound in the country, are a carte blanche to thise who benefit, a 'financial NRO'.

Chairman Federal Board of Revenue (FBR) Ali Arshad Hakim on Friday made a courageous admission before the Senate Standing Committee on Finance. According to him, the elite class and powerful lobbies have been granted huge tax exemptions through statuary regulatory orders (SROs), 'which is also a kind of financial National Reconciliation Ordinance (NRO).'

Giving a realistic picture of tax culture in Pakistan, the FBR Chairman informed the committee that the tax laws had given massive exemptions to influential groups and powerful lobbies through SROs. Unfortunately, however, general public finds it extremely difficult to start a new business due to discriminatory tax laws. The entire tax system is like an NRO for the elite class whereas the poor people cannot start their businesses in the existing tax environment, according to him.

He said powerful sectors had obtained extraordinary tax exemptions through SROs issued from time to time, adding that a narrow tax base in the country was evident from the fact that there were 805,465 corrected numbers of taxpayers during 2011. Additional revenue and documentation measures could generate Rs. 250 billion which can raise the Tax-to-GDP ratio by one per cent and the country could increase 2–2.5 per cent Tax-to-GDP ratio with the help of system, withdrawal of unnecessary exemptions and removal of distortions in the tax system.

The FBR Chairman also said that potential taxpayers were identified through consumption and behavioural patterns, including repeated foreign travels, multiple bank accounts, heavy utilities" consumption, expensive vehicles, weapons,

credit cards, posh residences, education, profession and family patterns (vacations, children studying abroad, etc). If all persons are taxed with the help of consumption behaviour, no income can be concealed anywhere in the country, according to him.

With the help of this 'data mine', 2.9 million tax evaders were identified; 2.2 million non-NTN holders and 0.7 million NTN holders but non-filers/evaders were also identified, Hakim said. He said the FBR was now equipped with 'a goldmine of data' and its effective utilization would facilitate the generations to come. He added that his department had very clear viewpoint on the documentation of potential persons. 'This data is a goldmine and we should have to use it very carefully to avoid misuse of the data,' FBR Chairman said. Around 200,000 persons would be documented without allowing them to avail registration scheme. According to him, these persons have exceptionally high expenditures and they have not even obtained the National Tax Numbers (NTNs). They will be registered under the existing tax laws. The remaining individuals would be allowed to avail the schemes. Once these persons are in the tax net, the department can ask them to file their income tax returns next year.

He said if the data of 2.9 million tax evader was given to the tax machinery for further action, it might not achieve the desired results. In such a situation, FBR would not be able to get any tax. Therefore, his department wanted to bring these 2.9 million persons into the tax net with the help of amnesty schemes. 'The legal process is very lengthy and amnesty scheme is the only way to bring these potential persons into the tax net,' he said.

In response to a question on corruption in the tax machinery, the FBR Chairman said that as Nadra chairman he used to transfer Nadra employees to significantly reduce the incidence of corruption. 'However, you can decide what should be done in the tax machinery, he added.

About the benefits of schemes, Hakim said the implementation of schemes would deepen and broaden the tax base; lifetime value of repeat tax payments. Database value will be much higher than yearly value; database will be a great help with creation of analytics for automatic detection. Moreover, it will help document the economy; improve Tax-to-GDP ratio; cause buoyancy in national economy; increase tax base & collection. According to him, the government will lower the tax rates in coming years and encourage people to bring assets to Pakistan.

In the past, the survey of markets and shops in 2000 remained unsuccessful as it was done through force without the support of any authentic data or third party information. 'It is not possible to forcefully bring these individuals into the tax net. We cannot document persons by using force which is evident from the past experience of tax survey of 2000. However, it could be done by providing them an opportunity to voluntarily come within the documented regime,' he said. Referring to investment made in Dubai, FBR Chairman said that the biggest weighing scheme had been seen in the form of investments taken to Dubai by local residents to whiten their money.

Business Recorder, Karachi, 29 December 2012

years, there are parliamentary requirements that reassessed rental values cannot exceed 10 per cent of the previous value. This continues to lead to an under-assessment of the true property value. Even if the rates are reassessed as frequently as they are supposed to be, the market values of urban property have increased by as much as fifteen or twenty times in recent years. Thus the assessed values would only capture a very small percentage of the real market rental values.

One of the main slogans raised by General Musharraf's government after it took over in October 1999, was the repeated claim that his government had established a devolved and decentralized system of government. The irony is that while there had been some devolution and decentralization from the provincial to the local (district) government level, there had been none from the federal to the provincial level. Both these factors had significant implications for resource mobilization at the provincial level throughout the duration of his rule.

As we have shown in the earlier sections of this chapter, a large number of functions previously in the jurisdiction of provincial government had been passed on to its district governments. In addition, new functions were also added to district governments. Aisha Ghaus-Pasha and Hafiz Pasha estimated that local governments would have required approximately 40 per cent of provincial budgets (both current and development) to fulfil the expanded functions.[37] However, as we showed earlier, district governments did not have the financial capacity to provide for even a fraction of these services. The burden then fell on the provincial governments, especially when they also had to come up with Provincial Finance Commission awards.

The problem was, that while provincial governments along with district governments, were to be held responsible for providing essential services, neither and especially the latter, had sufficient resources to do so. Without effective devolution from the federal government to the provincial—which includes the devolution of responsibility, power and financial resources—it was unlikely that the devolved district government system of 2001 could work effectively.

10.4.3 Local Government Revenues[38]

The common perception in the past has been that local governments were nonentities when it came to resource generation, expenditure, or the provision of services. Provincial governments were perceived to be the main providers of benefits to the people, and it was assumed that they were also better at raising revenues. However, the surprising evidence is that local governments in the earlier system prior to Musharraf's District Governments of 2001,

Box 10.7

The Rich Pay No Tax in Pakistan

Usman Manzoor, cites data from NADRA which shows that more than two million Pakistanis, almost all of whom are rich, pay no taxes.

The latest investigation conducted by a number of government organizations establishes that there are hundreds of thousands of multi-millionaires in Pakistan who enjoy elitist lifestyle but don't bother to pay tax.

The National Database and Registration Authority (Nadra), in collaboration with various departments, has compiled data of some 2,376,523 potential tax payers who do not have any National Tax Number. Sources in Nadra claim that if these tax-dodgers are brought into the tax-net, then the government can earn revenue of over Rs. 86 billion. However, FBR expects to fetch Rs. 176 bn revenue through amnesty schemes announced by it for tax dodgers.

These potential tax-payers include frequent travellers outside the country but not having NTN number. Similarly, people who do not have any NTN number but have multiple bank account holders; owners of posh residences and expensive vehicles; heavy consumers of utility services and posses arm licenses. Non-taxpayers in best professions have also been highlighted in the Nadra data.

According to the data compiled by Nadra, there are some 1,611,153 people who frequent travel abroad but are not NTN holders. Some 584,730 individuals having multiple bank accounts do not have any NTN. Similarly 56,421 owners of residences in posh localities are dodging the tax net as they do not have any NTN. Some 19,149 Pakistanis own expensive vehicles but are not NTN holders. As many as 66,736 individuals heavily consume utility services without any NTN, 13,201 individuals have arms licenses but do not have any NTN, 25,133 citizens are in the best profession but do not pay tax.

Through data mining 2,376,523 potential tax payers have been identified who are not even listed on the NTN master index. 'There are around 1,228,440 other than the potential taxpayers who are on the master index but exist in the non-filer category'.

The FBR will be briefing the prime minister regarding the findings of potential tax payers. The sources said Nadra and FBR would also be signing an agreement 'Broadening The Tax Net' in which Nadra would be identifying tax payers while the FBR would announce taxation schemes and enforce them.

The sources said 93 million Pakistanis have CNIC and this data is being integrated with the data of immigration, passport office, FBR, banks, etc so that the tax net could be widened.

The sources said there are thousands of citizens who fall in almost every category made by Nadra to identify potential taxpayers. For instance, a frequent traveller has a residence in a posh area and the utility services consumed by him are also very high and he also has multiple bank accounts and arm licenses. 'We will count two tax-payers not one if someone is living in a rented accommodation in a posh area and his utility bills are high as the owner of the house would be dealt for having expensive accommodation while the tenant will be dealt under living an elite lifestyle and dodging the tax net', the sources added.

Sources also disclosed that Nadra might get 1 to 2 per cent share of the revenue collected through potential tax-payers identified by it.

Source: Manzoor, Usman, 'Over two million millionaires have no NTN, studies show', *The News*, Karachi, 4 October 2012.

especially in large cities, had been successful in increasing their contribution to total revenues and there had been an improvement in the revenue mobilization efforts of local governments. In the 1980s, local taxes grew by an annual rate of 18 per cent, far higher than the growth in revenues at the federal or provincial level. Moreover, in 1990/1, prior to the 1991 NFC award, local governments contributed Rs. 8.8 billion in tax receipts compared to the Rs. 6.8 billion contributed by the four provincial governments. Hence, 6.5 per cent of total tax receipts came from the lowest tier compared to 5 per cent from provincial governments. But this figure should not detract from the very serious problems faced by local governments, some of which are discussed in this section and in Chapter 12.

Much of the credit for the good fiscal effort of local councils was due to a handful of large urban local governments and some districts. There were very large variations between the levels of effort and results in resource mobilization among urban and rural, and between small and large, councils. With just one tax—octroi—accounting for more than half of the revenue of nearly all urban councils, there could have been little disagreement with the urgent need to broaden the tax base of local councils. However, after octroi was done away with in 1999, local governments were forced to become dependent on federal fiscal transfers which compensated for this loss.

One area of reform that was identified was the way local taxes were collected. The provincial tax machinery collected the property tax and the tax on the transfer of property in urban areas, and the local rate in rural areas. The justifications given for provincial collection followed by revenue sharing of municipal taxes have been discussed earlier in Section 10.1.3.

However, the problem was that the buoyancy and revenue-raising potential of, say, the property taxes, depended on the reassessment frequency and value, as discussed in the previous section, where the provincial government played the only role. Since 85 to 95 per cent of the revenue was handed over to the local councils, provincial governments had few incentives to collect higher revenues as 'the net gain to them is very small in relation to the high political costs'.[39] Hence, arguments were made in favour of decentralizing the property tax to municipal governments. It was believed that local governments ought to have more incentive to mobilize

revenues so as to diminish their complete dependence on octroi, and that people may also have been willing to pay higher taxes because they saw a closer link between payment and the provision of municipal services. The most important point, however, was that 'provincial governments have pre-empted a number of taxes which fall within the fiscal powers of local government',[40] which meant that they had encroached on the revenue-generating avenues of local governments. Taxes such as the tax on the rental value of land and property, the motor vehicle tax, the tax on professions, trades and callings, and the entertainment tax could all have been collected by local governments.

Aisha Ghaus has argued that the 'current pattern of intergovernmental fiscal relations between the provincial and local governments in the country is such that the former *is instrumental in retarding the development*, in terms of expenditure growth, of the latter. This is the case because the provincial governments substitute for local governments in the provision of some important local services.'[41] After the 18th Amendment and with local government elections to be held after the May 2013 elections, one wonders how these persistent issues will be addressed.

Interestingly, there is also evidence from an analysis of the sharing of revenues from taxes of local origin, where there are

> sizeable transfers of resources in Pakistan from local jurisdictions to higher levels of government, especially provincial. This would seem to *justify some reallocation of fiscal powers* in favour of municipal governments and/or the establishment of more elaborate revenue sharing arrangements with provincial governments. The case for this becomes even stronger if a further devolution of functions to local governments takes place in Pakistan.[42]

This argument for decentralization to local government has gained much currency.

The extensive and detailed Applied Economics Research Centre (AERC) reports on local government[43] argued for decentralization, which they believed was 'justified on both economic and political' grounds. The economic justification rests on the premise that there would be an increase in efficiency in the provision of services, 'either by cost reductions or by enhancements in the quality of service (by more effective administration)', and that if local governments are included in the provision of services, then the quality of such services is also likely to be higher.[44] The main justification for decentralization based on political grounds has always been that decentralization ought to 'induce a sense of participation at the grass roots level of people in the provision and management of basic services that are of vital importance in influencing their quality of life. This process of involvement not only creates a sense of greater control and self-reliance but also provides for a clearer articulation of local needs and preferences.'[45] The presence of elected representatives from smaller communities is said to be 'beneficial' as local representatives have greater knowledge of local problems and priorities, and are supposed to be more accessible and involved in local issues. This view is also shared by Aisha Ghaus, who argues that

> decentralization of local services along with higher flows of funds to local governments is likely to improve the overall level of provision of local services in the country. Therefore, from a pure service delivery point of view a case exists for decentralizing delivery of local services to local governments. This strengthens the traditional arguments that have been made in favour of decentralization on economic, institutional and political grounds.[46]

If the arguments for decentralized local government are so obvious, why are there no elected local governments in Pakistan when democratic (or at least, elected) governments exist at the provincial and federal level? The answer is to be found in the political economy of power, its capture, its use, and its distribution. Often simple technocratic issues, which while well-meaning and probably correct, fail precisely because they are not located in a political economy framework or context, where the relationship to power, is central. Chapter 12, examines why it is, that local governments continue to, perhaps are made to, fail under elected governments, and why they are made to work under military dictatorships.

10.5 Summary and Further Reading

10.5.1 Summary

Government expenditures arise from the revenue that government can raise through taxation, or the money that it can borrow from domestic or external sources, or the money that it can print. In this chapter, we have looked at the taxation and revenue side of government and at the overall taxation structure that exists in Pakistan. The three tiers of government—federal, provincial, and district—all raise revenue and all incur expenditures. The largest share, in both revenue and expenditure, is made by federal government. With just 1 per cent of Pakistan's population paying income tax, indirect taxes provide about three-quarters of total tax collected, with sales tax the largest single contributor. We have also discussed in detail the National Finance Awards.

This chapter has identified and discussed the problems that exist between the three tiers of government, and has shown that each higher tier of government used to trespass on the jurisdiction and functions of the lower tier. The arguments for more decentralization to the provincial and local level were also made, and the numerous problems in the structure and administration of the taxation systems were highlighted.

10.5.2 Further Reading

The main sources cited in this chapter all deserve a thorough review. A large number of reports documented by the Applied Economics Research Centre (AERC) of the University of Karachi, in particular, deserve special mention. These reports are still the most comprehensive literature on the subject. The

following reports published by the AERC are recommended for a better understanding of the taxation structure in Pakistan: *Local Government Finances and Administration in Pakistan* (in two volumes), Research Report No. 72, 1990; *Resource Mobilization and Institutional Capacity* (in seven volumes), Research Report No. 85, 1991; *Resource Mobilization by Federal Government*, Research Report No. 91, 1992; *Resource Mobilization by Provincial and Local Governments in Pakistan*, Research Report No. 93, 1992; and *Metropolitan Resource Generation Study*, Research Report No. 97, 1993.

On the taxation structure, see Pasha, Hafiz, 'Political Economy of Tax Reforms: The Pakistan Experience', *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995; and Pasha, Hafiz and M. Asif Iqbal, 'Taxation Reforms in Pakistan', *Pakistan Journal of Applied Economics*, vol. 10, nos. 1 and 2, 1994. In addition, because there have been numerous changes in the taxation structure in recent years, the Central Board of Revenue *Yearbooks* and the annual *Pakistan Economic Survey* should be consulted. The following World Bank publications are also useful: *Pakistan: Growth Through Adjustment*, Report No. 7118-Pak (Washington DC, 1988); and *Pakistan: Country Economic Memorandum FY93: Progress Under the Adjustment Program*, Report No. 11590-Pak (Washington DC, 1993).

For the old system of local government and for a review of its history and related issues, see the following publications by S. Akbar Zaidi: 'Effective Local Level Delivery of Human Resources: Development Related Programmes—The Case of Pakistan', mimeo (Bangkok: UNESCAP, 1991); 'A Study on Making Optional Use of Municipal Budgets to Finance Child Development (Pakistan)', mimeo (Karachi: UNICEF, 1994); 'Urban Local Government in Pakistan: Expecting Too Much From Too Little', *Economic and Political Weekly*, vol. 31, no. 44, 1996; 'Urban Local Governance in Pakistan' in Islam, Nazrul and M. M. Khan, *Urban Governance in Bangladesh and Pakistan*, Centre for Urban Studies, (Dhaka: University of Dhaka, 1997); 'Politics, Poverty, Institutions: The Case of Karachi', *Economic and Political Weekly*, vol. 32, no. 51, 1997; 'Karachi: Prospects for the Future', in Khuhro, Hameeda (ed.), *Karachi: Megacity of Our Times* (Karachi: Oxford University Press, 1997); and the papers in Zaid, S. Akbar (ed.), *The New Development Paradigm: Papers on institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999). See also Chapter 12.

There has been much research and discussion on issues which have been raised in this chapter especially on the previous District Government. Amongst some reports that are available, see: Jackie Charlton et al. *Devolved Service Delivery Study: Emerging Concerns* (Islamabad: Asian Development Bank, 2003) and Nick Manning et al. *Devolution in Pakistan—Preparing for Service Delivery Improvements* (Islamabad: World Bank, 2003). Two Important academic papers are: Ali Cheema and Shandana Khan Mohmand's, *Local Government Reforms in Pakistan: Legitimism, Centralization or a Driver for Pro-poor Change?* (Lahore: LUMS, 2003); and Ali Cheema et al. 'Decentralization in Pakistan: Context, Contents and Causes', in D. Mookherjee and P. Bardhan (eds.), *The Rise of Local Government in Developing Countries: A Comparative Perspective* (forthcoming). Papers by Aisha Ghaus-Pasha and Hafiz Pasha: 'Devolution and Fiscal Decentralization', *The Pakistan Development Review* vol. 39, no. 4, Part 2, 2000, and Z. H. Anjum, 'New Local Government System: A Step Towards Community Empowerment', *The Pakistan Development Review* vol. 40, no. 4, Part 2, 2001, were amongst the earlier papers published on the new District Government system.

Since much of this chapter focuses on the pre-18th Amendment structure and system, references which look at decentralization after the 18th Amendment are given in Chapter 13.

A small selection of references on the fiscal deficit are given in the Notes, but a more detailed reading list including recent work is provided in the next chapter.

As has been argued in this Chapter, taxation is a major issue in Pakistan, yet recent research has been insufficient, both in quality and in the number of publications. See, of various quality: Pakistan Institute of Legislative Development and Transparency (PILDAT), *Taxing the Agriculture Income in Pakistan*, PILDAT Briefing Paper No. 42 (Islamabad: PILDAT, November 2011); Haq, Ikramul and Huzaima Bukhari, *Pakistan: Enigma of Taxation—Fitting the Pieces Together* (Saarbrücken, Germany: Lambert Academic Publishing, 2011); Nasim, Anjum, *Agricultural Income Taxation: Estimation of the Revenue Potential in Punjab*, Policy Brief No. 01–12 (Lahore: Institute of Development and Economic Alternatives (IDEAS), November 2012).

Appendix 10.1

The National Finance Commission and Fiscal Federalism

Jawaid Bokhari follows the 2003/4 debates around the earlier National Finance Commission Awards. The National Finance Commission (NFC) appears to have reached a near consensus on the ratios of tax revenues in divisible pool to be shared between the federation and the provinces. The radical departure made in the Award in 2009, is elaborated in detail in Chapter 13 in Part IV of this book.

Although federal Finance Minister Shaukat Aziz has not committed himself on exact ratios, the provincial finance ministers indicated to newsmen that it would be on 50:50 basis, up from 37.5 per cent for the provinces under the 1997 NFC Award and just over 40 per cent under the existing formula.

Whereas the share of provinces in the divisible pool will increase, the two minority provinces NWFP and Balochistan will lose subventions and grants amounting to Rs. 8.5 billion set aside for them by the previous NFC Award. The agreed Rs. 20 bn subventions and grants for the new award to which the federation was to contribute Rs. 15 bn and the provinces Rs. 5 bn, the lion's share coming from the Punjab, is to be shelved. In this case, the beneficiaries would have been the three minority provinces.

Earlier, officials estimated that the proposed Rs. 20 bn subvention and grants combined with 2.5 per cent of shares in General Sales Tax, assessed at around Rs. 40 bn, would have inflated the share of the provinces in the divisible pool to 44.6 pc.

The federal government is now in a position to spare more money for the provinces in view of the enlarged fiscal space, prompted by mounting public pressures to address the problem of rising poverty and unemployment. Nation-building is primarily in provincial domain.

If the share of the provinces is raised to 50 per cent, it would be a significant step towards fiscal autonomy of the provinces. The system of patronage, a product of feudal mindset, will be replaced by the eligibility of funds based on partial recognition of rights of the federating units.

Prior to the 1990 Award, the entire fiscal deficits of the provinces were picked up by the central government, breeding fiscal indiscipline and making provinces heavily dependent on Islamabad. Later, this led to freezing of provincial expenditures. The national financial system was designed to serve the unitary military government. The 1979 and 1985 NFC awards were not notified and nor were the provinces informed about any NFC decisions. For the first time, the 1990 Award laid some stress on self-reliance to improve fiscal management. It was a small step towards fiscal federalism.

But the 1997 Award deprived the provinces of a fair share of a fast growing revenue source—sales tax. Federal taxes were included in the divisible pool and the share of provinces was cut from 80 per cent to 37.5 per cent by an interim government having no public mandate. The surcharge on petroleum that yields Rs. 50-60 bn annually was kept out of the pool which Punjab rightly wants now to be included.

The 1997 Award was a device to shore up the depleting tax revenue of the federal government, eroded by rapid reduction in customs tariff under pressure of multilateral donors. The Award also terminated the cash development loans given by the federal government to the provinces. However, it gave a strong message that each province would have to manage its own resources within the centrally defined resource distribution framework.

Given the fiscal space, there are strong chances that fiscal devolution may gain momentum under Prime Minister Zafarullah Khan Jamali who enjoys good equation with his coalition partners.

Fiscal federalism is currently very weak. There is massive imbalance between taxes collected by the provinces (20 per cent) and the federation (80 per cent) All rich revenue yielding taxes are collected by a centralized authority. And the rate and incidence of taxes are adjusted, from time to time, by Islamabad with varying impacts on different provinces.

In India, fiscal federalism has been strengthened by allowing provinces to collect sales tax while retaining it as part of the divisible pool. 50 per cent of the sales tax proceeds are transferred to the central government by the provinces, says Dr Ayub Meher. Such an arrangement can help to stabilize erratic financial flows to the provinces.

The provincial governments have failed to tax effectively incomes on agriculture which contributes about a quarter of the country's Gross Domestic Product. It could become a major source of tax revenue, if properly tapped.

The current centralized system separates the taxing and spending authority for reasons of efficiency (that is questionable) and erodes accountability of the provincial governments to tax payers and of elected representatives to the electorate.

And again to quote an official, 'the central government periodically determines on the basis of needs, both the level of fiscal transfers and the method of distribution.' It damages provincial harmony.

As an understanding between the provinces and the federation on sharing of finances under the divisible pool seems to have been largely settled, the next NFC meeting (scheduled for 5 February in Karachi but may be postponed due to a holiday), will take up the issues of inter-provincial distribution. And indications are that sharing of pool money on the population basis may be replaced by a multiple factored formula such as population, backwardness, revenue generation and area.

With subventions and grants abolished, the money saved can be apportioned on the basis of provincial backwardness.

Currently, the divisible pool is shared between the provinces of the sole criteria of population: Punjab gets 57.88, Sindh 23.28, NWFP 13.54, and Balochistan 5.30 per cent.

Conceptually though not ratio-wise, it is not unlikely that inter-province distribution of resources may begin to follow the pattern set by provincial finance commissions (PFCs) for current expenditure.

Under the PFC awards, 60 per cent of the net proceeds of the provincial pool is retained by the provinces and 40 per cent, with marginal variations, is distributed among the districts. The federation and the provinces currently share federal divisible pool on the same basis.

The pool money is given to the districts on the basis of the following formula: population 50 per cent, backwardness 17.5 per cent, tax collection 7.5 per cent and transitional transfer 25 per cent.

Under the PFC awards for development expenditure, the first 'legitimate charge' is to provide counterpart rupee to foreign aided projects. 5 per cent from the left-over amount is set aside for compensating those districts which may get less revenue through formula-driven fiscal transfers.

The remaining amount is distributed in the ration of 30:70 between provincial based schemes and district government projects. And district allocations for development are shared as follows: population 50 per cent, backwardness 30 per cent, backlog of ongoing schemes 10 per cent and equal share 10 per cent. Karachi gets two and a half times higher than any district in equal share.

Khushhal Pakistan Programmes are distributed in the ratio: population 70 per cent and backwardness 30 per cent.

The formula for distribution of resources between the provinces and districts takes care of regional backwardness within each province. Similarly, there is some realization within the NFC that the divisible pool needs to be distributed on the basis of different stages of development of each province and its specific needs in the spirit of federalism.

Yet, fiscal federalism has multi-dimensional facets and poses problems which can only be resolved step by step. One aspect is the method of fiscal transfers and controls that makes financial flows erratic and retards the pace of project execution and economic development. Limits have been set for approval of projects by provincial (up to Rs. 200 million) and districts (Rs. 20 million. Projects costing over Rs. 200 million are sanctioned by the federal government. First of all, ceilings are pretty low and need to be revised from time to time.

Secondly, the efficiency at all levels requires that the three tiers of the government should be answerable to each other. Accountability should be a two-way street to become effective. The centralized system under which lower tiers of government are responsible to a centralized authority has failed to impart efficiency and enhanced productivity.

Source: *Economic and Business Review*, *Dawn*, Karachi, 2–8 February 2004.

Appendix 10.2

Constitutional Aspects of Taxing Agricultural Incomes

Huzaima Bukhari and Ikramul Haq make the case for imposing a proper agricultural income tax on Pakistan's untaxed agricultural sector.

Taxing agricultural income is the sole prerogative of provincial governments under the 1973 Constitution of Pakistan. These days confusion prevails about the laws in force for levy of income tax on agricultural income. It is strange to note that politicians, parliamentarians, TV anchors and so called experts are not clear about these laws. They keep on criticizing federal government for not levying income tax on 'agricultural income' without realizing that the fault lies with the provincial governments.

The total collection by all the four provinces under these laws was dismally low in 2009 at just Rs. 1.89 billion collected against the actual potential of Rs. 200 billion. The share of agriculture in GDP that year was about 22 per cent. The low collection proves beyond any doubt lack of will to tax the rich absentee landlords in Pakistan; their number is meagre but their clout in politics is very strong. This influential class includes the generals and other high-ranking military officers, who now own substantial state land, given to them as awards. They have emerged as a new landed aristocracy. Like barons of feudal Europe, they control our politico-economic system.

Presently, the provincial governments are not levying and collecting tax on agricultural income but charging a fixed tax on per-acre basis. The charge is usually Rs. 150 per acre from the irrigated areas and Rs. 100 per acre from non-irrigated lands. This acreage-based charge is in gross violation of the Constitution that stipulates tax on agricultural income as defined in Article 260(1). Entry 47, Part 1 of Federal Legislative List contained in the Fourth Schedule to the Constitution (it remains intact even after the 18th Amendment), empowers the federal government to levy 'Taxes on income other than agricultural income'. The expression 'agricultural income' is defined in Article 260(1) of the Constitution, which says: 'Agricultural income' means agricultural income as defined for the purpose of the law relating to income tax.'

The word 'means' signifies that this is an exhaustive definition that binds all the provincial legislatures to levy tax on 'agricultural income' as defined in the Income Tax Ordinance, 2001. However, the provinces, instead of following that definition, are levying fixed tax. Nobody has taken note of this gross violation till today. Both the federation and provinces under the Constitution are bound to follow the definition of 'agricultural income' as provided in the Income Tax Law while determining their legislative powers in terms of Article 70(4), Article 141, and Article 142 read with the Fourth Schedule to the Constitution. However, it is a matter of great concern that all the four provinces are perpetually violating the command of the supreme law of Pakistan.

Even a cursory look at laws (and amendments therein from time to time) promulgated by them, to tax 'agricultural income' shows that:

(a) Khyber Pakhtunkhwa has not even provided the definition of 'agricultural income' in its Northwest Frontier Province Agricultural Income Tax Ordinance, 1993. The tax levied under the name of 'Income Tax' is, in fact, a land tax on the basis of produce index units. This is nothing but a mockery of legislative process. If there was no political will to impose income tax on 'agricultural income', then what was the need to hoodwink the people by calling it Agricultural Income Tax? Since 1993 no government of the province has bothered to correct this anomaly. This shows the level of understanding of Constitutional provisions by our legislators (sic).

(b) The same is the case with Sindh Agricultural Income Tax Act of 1994 as amended from time to time. The PPP government is keen to collect VAT or sales tax on services, which it should as its constitutional right, but it has no desire to tax the rich pirs and waderas. Would this nation be informed how much tax is paid by Chief Minister Qaim Ali Shah, Makhdoom Amin Fahim, and many other feudal-cum-pirs of Sindh on their agricultural income?

(c) The Punjab Agricultural Income Tax of 1997, as amended from time to time, is no exception. No effort was made till 2000 to impose income tax on total income earned from this source. A face-saving device was introduced to levy yet another tax on acre basis at different rates in respect of irrigated and non-irrigated lands. Chief Minister Shahbaz Sharif has never bothered to tax rich absentee landlords of his province—many of whom dominate PML(N). Proper legislation should have been made as per Constitution to tax the Khosas, Gilanis, Quershis, Tiwanas, Sardars, Chaudharis, Maliks—just to mention a few. Such taxation could have provided room to initiate a number of meaningful welfare and job-oriented schemes for the have-nots, unlike the gimmick of sasti roti that was not restricted to the needy alone. But certainly, even the Sharifs have no intention to tax the rich and mighty feudals. They themselves have joined this class by grabbing many lucrative lands. See palatial palaces in Jati Umra, flats in Mayfair London, property in Saudi Arabia, Dubai, and elsewhere.

(d) In Balochistan, the position is no different. From 1993 to 1999, the Governor of Balochistan promulgated various Agricultural Income Tax Ordinances that were amended from time to time, following the same pattern as in the other three provinces.

The above analysis shows that none of the four provinces, while levying income tax on 'agricultural income' followed Article 260(1) of the Constitution. All the agricultural income tax laws passed by them are superficial whereas in substance no tax on 'agricultural income' has been imposed by any province, showing an attitude of contempt and apathy towards the Constitutional provisions.

None of the four provinces has levied income tax on 'agricultural income' as defined in the Constitution. The military and civil governments have consistently shown disrespect to the Constitution. This explains why constitutional democracy has failed to work in Pakistan; economic interests of landed aristocracy have primacy over the Constitutional rule whereas it should have been the other way around.

Source: This is an edited version of, Bukhari, Huzaima and Haq, Ikramul, 'Taxing Agricultural Income', *The News on Sunday*, Karachi, 19 December 2010.

Appendix 10.3

An Agenda for Tax Reform?

Shahid Kardar, a former Governor of the State Bank, proposes a comprehensive agenda to reform Pakistan's tax system.

Pakistan has one of the lowest tax to GDP ratios and, even considering developing countries alone, it is in the bottom ranked nations in terms of the proportion of population registered as taxpayers—less than 5 per cent of household population. There is rampant tax evasion, partly with the collusion of the official machinery. Whereas 3.1 million people have the National tax Number, a mere 1.2 million filed an income tax return in 2010/11. What is even more startling is that of 47,800 companies that have NTNs, less than 16,800 filed an income tax return against 400,000 industrial electricity connections.

As admitted by FBR, there is a tax gap of 79 per cent (the difference between potential revenues under the existing system and that actually collected). Revenues can be raised through broadening of bases, improving the equity of the tax regime, incentivising documentation, checking evasion by embracing a zero-tolerance policy, checking harassment of, or collusion with, taxpayers by simplifying tax returns and making FBR a faceless bureaucracy, with interaction between taxpayers and tax officials limited through greater reliance on automated computerised systems.

The general tax reforms would include taxation of all incomes of same levels equally irrespective of source, with a swift reversal of the travesty of the recent amnesty granted to trading in shares. There is also need for legislation that will render all Benami Transactions illegal and subjecting all cabinet members, who should all be taxpayers, to detailed tax scrutiny throughout period of office, and they should all be taxpayers. The tax returns and Wealth Statements of all parliamentarians and holders of key public offices and their spouses (including Secretaries, Chief Justices, Chief of Army Staff, Governor State Bank, Auditor and Attorney Generals) should be public during period of office and one year thereafter. Finally, following good results of tax mobilisation initiatives, individual and corporate income tax rates and the GST rate could be lowered under a phased programme.

The specific reforms under different tax heads would be the following: For Income Tax: Greater dependence needs to be placed on technology and through that on the CNIC for tracking commercial transactions to identify potential tax evasion/evaders, including movements in bank accounts of large deposit holders. The FBR should periodically reconcile the property tax registers of all provincial governments, names of credit card holders and members of private clubs with those allotted National Tax

Numbers, for the system to generate notices to non-filers. All presumptive taxes should be replaced by withholding taxes (which presently contribute 60 per cent of income tax revenues). And the rates of all withholding taxes should be increased by at least two percentage points as a revenue enhancing measure, to incentivise documentation and penalise those trying to avoid capture in the tax net.

To prevent tax arbitrage by major shareholder executives the tax differential between the highest individual tax rate and the corporate income tax rate should be narrowed sharply, if not fully eliminated. For individuals there should be a Minimum Asset Tax of 2 per cent which should be allowed as a tax credit. Such a measure is being proposed for reasons of equity and for ensuring that large farmers do end up paying some tax, considering the poor success that provincial governments have had in collecting tax on their incomes. Any CNIC holder receiving remittances of more than US$50,000 a year should be required to pay a tax at 5 per cent on receipts in excess of US$50,000.

There is also a need to consider re-introducing the scheme whereby unlisted companies paying a 20 per cent higher tax than that paid n the previous year would not be subjected to any audit. Adequate safeguards should be built into the system to prevent incentive abuse by entrepreneurs closing down existing companies/businesses and starting new ones. Bills in excess of Rs. 10,000 per month of domestic and all bills of commercial consumers of electricity should be subject to a withholding tax of 10 per cent and 15 per cent respectively. Compared with 3.2 million commercial electricity connections (excluding countless illegal connections) in the country today (including retail and wholesale outlets, offices of companies, partnerships, restaurants and hotels) last year only 22,000 wholesalers and 12,000 retailers paid income tax of Rs. 6.2 billion and Rs. 1.8 billion respectively paid income tax, either directly or under the withholding tax regime. By levying a minimum flat rate of Rs. 12,000 to Rs. 25,000 on small retailers more revenue can be raised. Large, well-known, retailers would be assessed for income tax in the normal way. However, it is recommended that the withholding tax on cash withdrawals in excess of Rs. 25,000 be abolished to incentivise the entry of the Rs. 1.7 trillion currency in circulation into the banking system thereby helping lower the government's debt servicing costs.

Moreover, provincial governments should tax agricultural incomes, using lease rates in the area or the revised produce index units as proxies of taxable income from agriculture. The current exemption limits for income tax purposes should continue to apply. However, to ensure that the database in the system at the Federal level is up to date all farmers with holdings of more than 50 acres should be required to file a tax return.

To augment revenues from the under-exploited provincial property tax, 'rental values' for determining property tax liability of residential accommodation should be assessed at 1 per cent. of property 'market values' with a small tax credit for self/owner-occupied residential properties and appropriate exemption limits for small sized residential space. For commercial properties 'rental values' should be assessed at 3 per cent.

In the case of GST the proposed reforms are: the rate for sales to entities registered for GST should be 12.5 per cent while for unregistered it should be retained at the base rate of 16 per cent, the latter being the rate that is charged to the final consumer. For extending sales tax to retail trade, we need to examine the possibility of a single-stage sales tax to be levied by a provincial government based on location, shop area and nature of business.

For Customs Duties, to check abuse we need to identify items prone to dumping and under-invoicing and a system of ITPs should be introduced. As long as this list is a short one, the country will not run-foul of WTO rules and regulations. To both enhance revenues and simplify the tariff structure there is a need to consider levying a minimum rate of duty on all imports other than those protected by sovereign agreements (currently Rs. 1 trillion worth of imports are duty free). We have a highly distortionary tariff regime that levies different rates of import duties on the same material based on the consuming industry, thereby creating opportunities for 'extracting rent'. There is a need to simplify the tariff structure further by considering a system of 'one-chapter one-rate'.

Finally, to address issues related to Afghan Transit Trade, we should consider incentivising use of Pakistan Railways for transportation and employ use technology-tracker and GSP systems. We can also consider using quantitative restrictions for items prone to smuggling.

On the administration side, focus should be a) on improving the quality of FBR's data warehouse and IT systems; b) ensuring that the taxes collected by the 'withholding agents' or from the end consumer in the GST are eventually deposited in the governments' coffers; and c) on audit/tax notices being generated electronically stating in detail the reasons why the system raised the notice. And to check collusion, two tax officials should be required to sign the notice and interview the assesee.

The above should represent the minimum tax reform agenda for any new government to assume office after the forthcoming elections. It should be able to generate additional revenues of 1 per cent of GDP per annum. However, while some proposals will be politically tough to implement as they will require legislative changes or face resistance—not to mention the estimate of additional revenues each year looks ambitious in a sluggish economy—the continued postponement of fundamental revenue, expenditure, policy and institutional reforms is also no longer sustainable.

Kardar, Shahid, 'Tax Reform Agenda for Next Government', *The News*, Karachi, 28 March 2012.

Appendix 10.4

How Can Taxes Be Increased?

Sardar Irshad Shaheen, in a detailed article, discusses numerous ideas and proposals to raise Pakistan's tax to GDP ratio. This is an edited version of a longer article.

High tax rates and an overall complicated tax system in Pakistan are the main causes of the black economy and tax evasion, non-documentation and corruption. The informal sector is thriving due to unchecked illegal activities such as smuggling, black marketing, and drug trafficking that are taking place in major parts of the country to the advantage of pressure groups who are helped by powerful mafias and vested interests. They are further promoted and protected by politico-bureaucratic amalgam through erosion of institutional stability and hollow cosmetic measures.

It is a proven fact that all taxes in any shape are unwelcome, but income tax is the most unpleasant of all taxes, and it remains so in whatever from it is introduced anywhere in the world. A chief reason for its unacceptability is that it does not provide any direct return or benefit to the taxpayer.

A country's tax system can be successful only if it has:

(1) Clarity of law and communicable simplicity of procedure. (2) Stability in institution building and continuity of policies for promoting tax culture, in accordance with the stage of development of a society. (3) Specialised and professional top management equipped with practical experience in tax field. (4) Enforcement of law in letter and spirit. (5) Provision of incentives to the taxpayers with some direct social and material advantages.

Simplicity of tax law and procedure will not succeed unless the number and rate of taxes are reduced to a reasonable level. A few years back more than hundred different taxes were in operation in our country out of which the most frequently charged 77 taxes included; 20 federal taxes, 19 provisional taxes, 14 local taxes and 24 other levies and surcharges. The businessmen were entirely at the mercy of various government departments. The tax rates were also unreasonably high since it was an easy way to increase revenues by increasing the number or rate of taxes.

Simplifying tax laws through experimentation:

Legal provisions under the Income Tax Act 1922 were considered quite complex particularly due to new requirements faced by taxpayers in the emerging business environment. This act was replaced by the Income Tax Ordinance, 1979, in which legal provisions and procedures were re-arranged in a much simplified manner. It was welcomed by all the stakeholders. There was no strong demand to replace this law by a new one. The only demand of the taxpayers then was that Universal Self Assessment Scheme be given legal cover instead of changing it every year through circulars.

Nevertheless to the amazement of every stakeholder, a new law was drafted not by local experts, but by a foreign expert completely oblivious to the local conditions purely on the pattern of a developed economy. This law became operative as the Income Tax Ordinance, 2001. Even senior field officers were not taken into confidence and the entire exercise was done under the compulsion of IMF and World Bank. In the name of reforms every detail was prepared by IMF through a 'confidential' paper in which the designation, nomenclature, the design of offices and number of officers and employees were proposed by foreigners. The dominant role allowed to the World Bank and IMF made many field officers believe for quite some time that funds for reforms supplied by these institutions were grants and not loans. Not only was the road map prepared by the IMF followed literally, but the loan money had been squandered recklessly. After the promulgation of the Income Tax Ordinance, 2001, more than four hundred amendments had to be made in it during the first month alone. Over two thousand amendments have so far been made in the Income Tax Ordinance, 2001, as it was not in tune with the domestic requirements. It was an unnecessary exercise of mere experimentation which greatly eroded the institutional fabric of the tax organization and added a great deal of confusion.

After the operation of the Income Tax Ordinance, 2001, repeated concessions were allowed to taxpayers some of which were not even demanded by them. Our system of income tax today is one of the most concession-orientated systems in the world. But compliance of tax laws has shown no improvement.

In comparison, India redrafted the Income Tax Act 1922 in 1961 and income tax laws have been enacted under the Income Tax Act 1961 with effect from 13-09-1961. In this act amendments have been made through 109 finance acts so far. These amendments have been smoothly made by adding additional sections and sub sections without drafting new laws again and again. For instance in Chapter-VI A dealing with some deductions, section 80A has 67 additional sections (besides sub sections) from section 80A to 80 VVA, and section 115 has 75 additional sections from 115A to 115WL. Indian income tax rules revised in 1962 are still operative. We replaced the Income Tax Act 1922 with Income Tax Ordinance 1979, which was repealed and replaced by the Income Tax Ordinance 2001 drafted by a foreign expert based on the model of an advanced country.

The Indian tax system had the closest affinity with our business and social environment since both countries inherited the Income Tax Act, 1922. But instead of sharing common experience with Indian tax laws, we preferred aping a model of a distant advanced country having little relevance to our ground realities.

Erosion of FBR as an institution:

An imported finance minister (later prime minister) had managed to thrust upon the FBR five members from the private sector who had little working expertise in a taxation department. Huge amounts were spent on them as perks with hardly any positive achievements. All this was done in the name of reforms and introduction of fresh (but alien)

experience in this specialised organization. These members could hardly match the career tax officers having over 30 years of practical field experience. The officers and workforce remained disillusioned and no positive long lasting result could be achieved. Major attention was focused on withholding tax which has been imposed on nearly every consumable item or receipt, and income tax got converted into an indirect tax which is suicidal for the very spirit of direct tax system. Even the formulation of the budget has been artificial as major chunk of revenue came from sales tax, customs duties and withholding tax on constantly increasing imports. So when these sources fell, the budget target also fell significantly. As if this was not enough, the federal government appointed a generalist as chairman FBR last year (who was junior to 38 officers of FBR). This was done at the most crucial time, when collection of revenue was most needed during the end of last financial year and the government could ill afford such an adventure. When the career members protested at this appointment, they were sidelined. This year too, just four months before the end of the financial year, the previous head of FBR has been replaced by a new generalist officer. The appointment of a generalist as head of a technical and professional organization reflects total disregard of national interests, particularly at this critical time.

Such an attitude appears to be a deliberate attempt to erode national institutions which is a classic example of bad governance. The undeniable fact is that FBR has been failing in raising its tax-to-GDP ratio due to: (a) excessive experimentation and resultant erosion of intuitions, and (b) little importance given to career offices and tax experts in policy making and top postings.

Current state of affairs:

(1) The budget target of the FBR was fixed at Rs. 1,630 billion which was revised and re-fixed at Rs. 1,588 billion. With two months left, FBR's total collection up to April 2011 was Rs. 1,147 billion, leaving Rs. 441 billion balance to be collected. Collection of such a huge amount does not appear to be possible. The policymakers not only banked heavily on foreign borrowings but had no definite plan for the economy despite the energy crisis, slash in PSDP (twice) and substantial interest payments on foreign debt amounting to Rs. 1,300 billion, which consumed a large proportion of the national resources together with expenditure on the war on terror.

The quality of economic analysis and research of our financial experts can be found in Economic Survey 2009-10. The information and figures spread over various pages lack any descriptive scrutiny leading to no direction. As a whole the survey appears to have been prepared with no thought or effort. If such is the government's priority then one should not be surprised if the revenue system today is in such a mess.

(2) As pointed out earlier, our income tax system today is heavily concession oriented, but despite that the tax base has not expanded adequately and the tax-to-GDP ratio is still plummeting.

Taxpayers must be provided a guarantee of stability in tax rates and procedure of the system. Legal guarantee of Universal Self Assessment has been provided through statutory provisions in the Income Tax Ordinance 2001. Every return of income filed by a taxpayer is to be accepted irrespective of declared figure of income or loss. The rates of income tax were also to be reduced with some variation and the minimum rate should be half per cent and maximum twenty per cent for every taxpayer including the corporate sector. This would have reduced evasion, malpractices and corruption, resulting in expansion of the tax base. But the government fixed the rate at 35 per cent on corporate sector whereas on salary income, the maximum rate was reduced to 20 per cent. The FBR has again failed to appreciate the role of continuity and credibility of tax laws. Having failed to broaden the tax base, tax rates have been increased on all classes of income with complicated methods.

(3) The government on the advice of non-technical consultants and advisors has constantly been introducing whitening schemes, despite the fact that foreign remittances through banking channels were a constant source of whitening the untaxed money. The latest adventure by the government was that only two per cent tax was to be paid through a whitening scheme for whitening any amount of assets or black money, but the response was a paltry payment of Rs. 3.2 billion income tax for whitening assets, just 1.23 per cent of the total size of economy. This sorry state of affairs in the presence of every concession allowed by the government is most unfortunate and speaks loudly of the apathy of the policymakers. This also shows that the government would not want FBR to be an independent stable institution run by experts and experienced tax officers. Obviously the first priority of the government must be that highly experienced career officers of tax service be posted to top management levels of FBR and there should be no room for any mediocrity.

(4) Back in 1998 the number of taxpayers stood at 961,090. These taxpayers included salaried persons (411,000) and business class (534,000). After eleven years the position as on 30-06-2009 and 30-06-2010 was as shown in Table-1.

The figures in Table 1 clearly reflect the dismal performance of the policymakers. The documented sector (or corporate sector) is very small which mainly bears the brunt of tax collection. Top one hundred taxpayers paid Rs. 174 billion in 2010 besides deduction at source and advance tax (mostly paid by petroleum, banking and manufacturing sectors). Other than the active registered companies and salaried class, the number of business taxpayers is quite low. Their share in the income tax collection is less than 10 per cent of the gross collection whereas the share of a salaried person is 7 per cent. After deducting the collection of tax paid by corporate sector at Rs. 176 billion plus gross withholding tax (with CVT collection), the balance amount left is Rs. 15 billion only which is around 3 per cent of total tax collection. It is argued that the business community pays withholding tax on almost each item, but the same is true of the whole population including the large majority of poor people. The common man pays withholding tax on mobile phones and other items (including CVT), which was almost 54 per cent of the gross income tax collection in 2009. It may also be added that corporate sector, government corporations, banks and some multinational companies including oil companies, have been

paying bulk of the tax revenue. Almost the same number of companies (one hundred) paid over 80 per cent of indirect taxes. Obviously the number of regular business taxpayers who filed returns of income could not increase.

(5) Overall collection of FBR as on 30-06-09 and 30-06-10 shows an unpromising situation. (see Table-2)

The figures in Table 2 indicate that the amount of withholding income tax, sales tax on imports and federal excise on imports and customs duties works out to be 51 per cent and 63 per cent in both years, respectively. Major source of even domestic sales tax and federal excise duty comprise of:

(a) Consumption of sugar and products of edible and medicine, etc.
(b) Utility bills and excise duty on bank transaction.
(c) Purchases by government and semi-government organizations, corporations and various contracts. Add to it the withholding tax on almost every item and it would be clear that the burden of 70 per cent of all taxes is being borne by the common man through indirect imposition of taxes.

It is a matter of grave concern that the situation is deteriorating. The tax-to-GDP rate has plunged to 8.8 per cent. The number of income tax business returns received during the last two years was quite unsatisfactory.

As regards to sales tax, the situation is worse. The number of enrolled sales taxpayers is merely 102,167 and only 90,204 returns are now regularly being filed. During the financial year ending on 30.06.2010, only one hundred corporate taxpayers paid 81 per cent sales tax (Rs. 240 billion) out of a total collection of Rs. 295 billion domestic sales tax. A major amount of domestic federal excise duty was also paid by only twenty four corporate taxpayers (mostly petroleum companies).

Solution:

The past experience of over three decades leads us to the conclusion that frequent experimentation and outside interference has caused erosion of the FBR as a stable tax collecting institution, with severe repercussions for the taxpayers and officials alike. The Central Board of Revenue was re-designated as Federal Board of Revenue through an act of parliament with effect from 1 November 2007 as a semi autonomous body after years of deliberations and efforts. The newly established organization's performance was affected by mindless experimentation and appointment of non professional individuals at the helm of affairs. The FBR appears to lack direction and functions without proper coordination among various tiers of its departments. There is great deal of confusion and dissatisfaction all around.

If the government is really serious in tackling the issue of tax revenue collection, it must consider the FBR as an essential state institution. The right people for the right job must be a permanent feature with well defined career-oriented expertise in the organizational hierarchy. In areas like reforms and restructuring, the task must be left to experienced and senior officers of FBR only, who can re-examine every aspect of structural anomaly according to the actual requirements and ground realities. It must be emphasized that the FBR needs to be strengthened as an organization based on professional competence.

The following measures, therefore, need to be adopted for immediate and long-term stability and efficiency of the taxation system, which would also help to expand the tax base and increase revenue:

A - (1) FBR is traditionally plagued with political pressure and bureaucratic (vested interest) influence. The first step should be to select a chairman of FBR on merit. For this purpose, the post of chairman should be advertised for selection through Public Service Commission for a fixed tenure of four years based on academic qualification and professional experience. Such a step would go a long way in stability and efficiency of the FBR with no apprehension of political interference.

(2) Job classification with career planning must be clearly defined with strict application at all levels for postings and transfers. Job performance of various sections of FBR needs to be revamped for better coordination and only those officers should be posted in FBR who have sufficient field experience turn by turn for a fixed period.

(3) A full fledged research and development wing needs to be established to guide the FBR in the tax policy matters and suggest practical ways for effective coordination between FBR and field formations in the light of ever emerging new situations.

(4) Systems of appraisement of customs duty and Pakistan Customs Computerised Systems (PACCs) and system of sales tax processing and Sales Tax Automated Refund Repository System (STARR) should not be closed, but upgraded for application in all the dry ports and sea ports to make them transparent and less time consuming. Only fully trained and honest officers should be empowered to appraise and assess tax liabilities in accordance with best practices principle.

(5) Smuggling is perhaps the most lucrative and organized business in Pakistan and smuggled goods are sold openly everywhere particularly due to misuse of Afghan Transit Trade (ATT). Many departments including Federal Investigation Agency, commerce ministry, and foreign office deal in anti-smuggling cases. Other agencies like Coast Guards, Frontier Constabulary, Levies and even the police department have been given anti-smuggling powers. It not only creates overlapping and delay in taking proper action, but it also becomes a source of organized corruption which explains why smuggled goods are available not only in big cities but also in small towns. These agencies mostly run after tracing smuggled goods for corrupt practices and they do not focus on their own duties. A single agency fully trained and equipped must be empowered in dealing with anti-smuggling in an effective and transparent manner.

(6) All exemptions from sales and income tax should be withdrawn. The chief commissioner should be empowered to allow exemption in genuine cases for a specified period.

(7) At present only one hundred taxpayers of the corporate sector pay 90 per cent of sales tax on imported and domestic items. To make it acceptable within the business community, sales tax or RGST should be considerably reduced to 5 per cent starting from a fixed rate of 1 per cent or Rs. 100 on specified monthly sales (gradually increasing up to 5 per cent which should be adjustable). Sales tax at the rate of 1 per cent should also be imposed on defence purchases as well as on

all medicines which should be non-adjustable. International tenders should also be taxed 1 per cent non-adjustable sales tax.

(8) Federal excise duty should be merged with sales tax to reduce the number of taxes and hassle for the taxpayers. The sales tax system must not only be fully automated to minimise delays and corruption, however a strict system of audit should also be put in place to eliminate the misuse of the system.

(9) Claim of refund on account of input cost has been a major source of corruption and malpractice. This can be curbed by reducing sales tax rates and abolishing exemptions. Instead alternate incentives can be offered to exporters including exemption of income tax and other taxes/levies on exported goods.

B - (1) Tax revenue enhancing measures:
For expanding the tax base, some provisions of law need to be amended/added to ensure that:

(a) All property transactions involving plots of 2 kanals and above in the urban areas of big cities should be registered only after verification of national tax number (NTN) of seller and purchaser;

(b) Similar method should be adopted for sale and purchase of commercial property of any size in big cities;

(c) All types of vehicles with market value of one million rupees or above should be registered/transferred after verification of NTN from the tax officer;

(d) Every person travelling abroad, except students and foreign nationals should be required to obtain NTN from the income tax department. This should also include travel for Umrah, Hajj or Ziarat, medical treatment and personal visits;

(e) Expenditure on lavish functions, including marriage and social/political gatherings and conferences should be taxed either at a fixed rate or booked for assessment of income after verification of NTN of the person concerned;

(f) Services sector is highly under taxed, particularly the income of surgeons, physicians, advocates and professionals rendering consultancy services. Surgeons earn an average of Rs. 0.5 million to Rs. 20 million per month. A specialist's income ranges from Rs. 0.2 million to Rs. 1.5 million per month, whereas their annual declared income is generally even less than their monthly income. Fees of private professional colleges and schools are also very high. Their share in revenue is nominal but no meaningful audit has ever been conducted. A mechanism needs to be adopted to properly tap this very important under taxed source of revenue;

(g) For better compliance, tax returns should be prepared in Urdu together with pamphlets for proper guidance of taxpayers.

(2) Making the tax laws equitable:
(a) The most frequently raised objection by the business community in particular and public in general is that politicians are selected by the people to safeguard their rights and are supposed to make laws in the best interests of the populace. Nonetheless, our politicians violate the law themselves when it comes to paying tax. Statistics show that very few legislatures of the national, senate and provincial assemblies are on tax rolls; and those who have a NTN pay an insignificant amount compared to their lavish expenses. It should be made mandatory under the law for every person contesting in the election (at any level) to get a NTN and file their return of income and wealth statement. Any person found guilty of tax evasion must immediately be disqualified. Such a step will give substantial boost to payment of taxes as leaders of the people will become a role model for them, dispelling the public perception that they consider themselves above the law.

(b) Due to a powerful lobby of authoritative landowners, agricultural income is exempt from income tax as it is a provincial subject under the constitution. Tax exemption to such a large section of economy reflects a huge distortion and the tax laws appear as inequitable. Taxing the agriculture income will make the taxation system not only equitable but it will greatly help boost the low tax-to-GDP ratio. Three steps should be taken in this direction:

(i) Agriculture land up to 15 acres should be exempted from income tax.

(ii) Income tax rates should be reduced (even for other taxpayers) to make the tax acceptable and to reduce the tendency of evasion.

(iii) Agriculturists can be compensated by provision of cheap fertilisers, electricity and irrigation water

(c) At present the FBR has not devised a worthwhile effective procedure of audit both for income and sales tax. There is no practical deterrence against evasion of tax after introduction of Universal Self Assessment Scheme. There needs to be a transparent provision in law that each case shall be audited on its turn after every third or fourth year (unless caught earlier on account of some definite evasion).

(d) Typically traditional bureaucratic method for raising revenues is to increase the rate of tax and number of taxes, which is counter-productive as such a method encourages tax theft and makes the tax base shrink. Not only the minimum rate should start from the lowest slab, but the maximum rate of income tax should not be more than 20 per cent, as no one would willingly pay tax more than that. Instead of promoting short-term interests, the FBR must bring the tax rates to a reasonably acceptable level so that measures adopted for increasing the number of taxpayers and revenue become fruitful. Lower tax rates can be a better tool of persuasion for taxing agriculture income. Moreover, another very important advantage of lower tax rates would be that it can help in introducing sales tax even at the retail level. The traders dislike documentation due to fear of paying income tax. If they can declare maximum receipts and incomes because of lower tax rates, the resistance to the imposition of sales tax would be minimised.

(3) Wealth tax:
(a) Wealth tax was abolished in 2000 under the pressure of powerful lobbyists, comprising mostly of civil and military bureaucracy, who did not want to pay wealth tax on their properties and plots. Tax on wealth is an important instrument of a fiscal policy which endeavours to establish an equitable economic system. Due to rising trend of investment in non-productive sector like properties, it would be advisable to impose wealth tax on all immovable properties at a fixed rate to be paid at the time of purchase/transfer. Wealth tax on each property measuring 2 kanals and above should also be

charged annually. Other assets including costly vehicles can also be taxed accordingly.

(b) All the measures require the will of the government to enforce the law in letter and spirit. Successive governments have been bullied by apprehension of traders' strikes, and they have wrongly considered them their decisive political constituency. A few hundred thousand traders can never change the fate of a government or political party if it remains more sensitive to the well being of the large population of 180 million people. Moreover, the ruling elite itself sometimes proves to be biggest hurdle in the enforcement of law. A tax collector sent his officials to monitor sales of one restaurant in Lahore, which incidentally belonged to the minister of state for finance. The collector was immediately made officer on special duty (OSD) and the whole campaign resulted in a fiasco. The political leaders in general and the party in power in particular consider themselves above the law. Such a mindset would never enable us to stand on our own feet.

Table 1

S. No.	Total Number of Tax Payers	Year ending 30-06-09	Year ending 30-06-10
1	Number of companies	18973	19755
2	AOP Cases	28779	31135
3	Salaried Cases	145019	196101
4	Non corporate business	549252	638633
5	Number of return filers	765461	1444389
6	No. of persons shown in statements, certificates of salaries, imports and exports, etc.	1766998	2313606

Table 2

Taxes	Year ending 30-06-09	Year ending 30-06-10
Sales Tax (total)	478284m	516348m
(1) Sales Tax on imports	203323m	247246m
(2) Sales Tax on domestic	274961m	269102m
Federal Excise Duty (total)	113715m	124784m
(1) FED on imports	14617m	13557m
(2) FED on domestic	99098m	111227m
Customs (Net)	155905m	160273m
Income Tax (Net)	480487m	525977m
(Including withholding tax + CVT)		

Source: Shaheen, Sardar Irshad, 'Higher revenue generation: an uphill task', http://jang.com.pk/thenews/may2011-weekly/busrev-23-05-2011/index.html accessed 10 July 2012.

Appendix 10.5

Key Issues in Pakistan's Taxation System

Maleeha Lodhi details many of the main issues in Pakistan's taxation structure which continue to keep the tax-to-GDP ratio below 9 per cent.

The prize for the most disingenuous response of 2012 must go to the group of parliamentarians who cast a report on MPs' tax-paying record as a conspiracy and chose to shoot the messenger rather than address the message.

The findings of 'Representation without Taxation' are important though unsurprising in a country where less than one per cent of people pay income tax. The study revealed that nearly 70 per cent of members of parliament did not fulfil their legal obligation to file tax returns in 2011. Eighty-eight lawmakers did not have a national tax number (NTN). More than half of the cabinet ministers did not bother to file returns. Those who paid meagre amounts inconsistent with their lifestyle included the prime minister and foreign minister.

The report showed that the national practice of tax evasion is rampant among lawmakers. Its conclusion was clear: 'The problem starts at the top. Those who make revenue policies, run the government and collect taxes have not been able to set good examples for others'.

The reaction from most parties in parliament was of indignant denial. Many castigated the report as an effort to 'defame politicians'. Others wrapped themselves in victimhood. 'Why pick on us, why not others?' said one, as if 'others' could serve as alibis for their malfeasance. This pass-the-buck stance was reinforced when the National Assembly's finance committee asked the Federal Board of Revenue to prepare a report on how much tax judges, generals and civil servants paid.

Instead of this transparent bid to obfuscate the issue, parliamentarians would have been better off welcoming a debate, admonishing tax-dodgers in their ranks, correcting any errors in the report, but above all highlighting the serious consequences that flow from the state's inability to collect taxes. The report should have urged parliamentarians to examine why the country lacks a tax culture and propose ways of addressing this to signal the importance they assign to the issue.

Pakistan's tax-to-GDP ratio of less than ten per cent is at the heart of its enduring fiscal troubles. Failure to generate domestic resources is a major factor for the country's economic stagnation and why the economy is in the critical ward today.

A decade ago, a task force established to reform the tax system held out a stark warning: 'Pakistan's fiscal crisis is deep. Taxes are insufficient for debt service and defence. If the tax-to-GDP ratio does not increase significantly Pakistan cannot be governed effectively, essential public services cannot be delivered and high inflation is inevitable. Reform of the tax administration is the single most important economic task for the government'.

This counsel has long been ignored. Availability of external financing from overseas official assistance has acted as a disincentive for reform. Bank borrowing—printing currency notes—to finance budget deficits has served as a 'substitute' for taxation but at great cost to the economy.

Mobilisation of domestic resources continues to be a story of weak political will, half-hearted reform, poor enforcement, dependence on foreign inflows and domestic borrowing, and ascendancy of powerful political and economic lobbies. Successive governments' inability to raise revenue can mostly be explained in terms of a 'privilegentsia' that refuses to tax itself and is averse to measures that can undermine its economic interests.

This has contributed to miring Pakistan in perpetual financial crises that are temporarily 'resolved' by bailouts from abroad, either as strategic payoffs for its foreign policy alignments or promises of reform, which are reneged on as soon as front-loaded tranches are received from multilateral lenders.

The sorry state of tax efforts is laid bare by the dismal statistics. Tax as a percentage of GDP has remained virtually static for decades. Hovering around 11 per cent in the 1990s, it fell to nine per cent in the last decade and has stayed there, making it among the lowest in the world.

This is not the only disconcerting indicator. The number of income taxpayers rose from an abysmal quarter of a million in 1995 to a million in 2000. By 2011 the number of people registered with tax authorities through NTNs increased to 3.1 million. But only half or 1.5 million filed returns. The number of income taxpayers actually dropped from one per cent of the population to 0.92 per cent in the past five years.

This fact is more telling when set against data from the 2011 household survey that shows the number of people earning enough to pay income tax. Only 17 per cent of 4.5 million taxable Pakistanis—one in six—are verifiable taxpayers. The rest do not pay tax.

A more fundamental issue is the large swath of the formal economy that is still untaxed. The most spectacular example of a privileged elite's refusal to pay is the absence of an agricultural income tax. Agriculture accounts for around 20 per cent of GDP and employs 40 per cent of the labour force but yields little more than one per cent of total revenue. The service sector, which now contributes the largest share to GDP—around 50 per cent—contributes just 16 per cent to revenue. Of over a million taxable retail outlets only about 160,000 are registered. Of these less than 28,000 paid tax last year.

This means that at least 70 per cent of the formal economy is untaxed, lightly taxed or non-compliant. If the informal, undocumented economy is factored in, an even larger swath of the economy is outside the tax net.

Not only is the present tax regime inelastic, it is also iniquitous, putting a heavier burden by way of indirect taxes on those least able to bear it, while offering the powerful 'legal' escape routes. The SRO regime exemplifies this. Statutory regulatory orders are administrative instruments providing ad hoc exemptions that have been used by successive governments to grant concessions to special interests, individuals and sectors. This translates into billions in lost tax revenue. Last month the finance minister told parliament that Rs. 650 billion worth of exemptions and tax waivers were given in the last four years alone. This regime fosters cronyism and negates any notion of a level playing field.

An unfair tax system is an important reason behind low revenue collection and poor compliance. Relatively high rates of tax are imposed on a narrow band of people and a few sectors. The corporate sector for example is the highest contributor (62 per cent) to direct tax revenue. But non-compliance in corporate income tax is also high at 58 per cent.

Systemic weaknesses in tax administration produce major 'leakages'. The 2001 task force found that 50 per cent of due taxes never reach the treasury, illustrating the power of the rich to thwart the law. The IMF estimates that the equivalent of $3 billion raised in revenue never makes it to the exchequer because of collusion between the influential and the tax bureaucracy.

Inability to raise enough direct taxes has led to reliance on indirect taxes, many of which are regressive. For example Pakistanis pay a greater proportion of their income as tax on petrol than any other country in the world. The major contributions to revenue are: direct taxes (39 per cent); sales tax (43 per cent); customs duty (12 per cent) and federal excise duties (6 per cent). Indirect taxes, however, are woefully inadequate to meet budgetary requirements.

To resolve its chronic fiscal crisis and generate the means for its future progress, Pakistan has to raise more revenue. Unless the present nine per cent of GDP is increased by at least 3–4 per cent, reliance on deficit financing through borrowing, with all its pernicious economic effects, cannot be ended. This is essential to reduce inflation, the cruellest 'tax' on the poor and major cause for the rise in poverty in recent years.

The key question is this: how can Pakistan chart a way out of a growing fiscal crisis, overcome economic stagnation and reverse the deterioration in public services without broadening its tax base and ensuring equity and efficiency in revenue collection? Parliamentarians ought to focus on answering this question rather than assailing those who only held up a mirror to their conduct.

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NOTES

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2. Ibid.
3. Ibid.
4. See the following reports prepared by the Applied Economics Research Centre (AERC), Karachi: *Local Government Finances and Administration in Pakistan* (in two volumes), Research Report No. 72, 1990; *Resource Mobilization and Institutional Capacity*, (in seven volumes), Research Report No. 85, 1991; *Resource Mobilization by Federal Government*, Research Report No. 91, 1992(a); *Resource Mobilization by Provincial and Local Governments in Pakistan*, Research Report No. 93, 1992(b); *Metropolitan Resource Generation Study*, Research Report No. 97, 1993.
5. Although the 1979 and 1980 Ordinances were supposed to be operative, in effect, all local governments were dismissed in the 1990s and local bodies were run by federal and provincial government-appointed Administrators. See also section 10.4, below.
6. AERC, op. cit., 1990, (iii).
7. See AERC, op. cit., 1990, and AERC, op. cit., 1992(b).
8. AERC, op. cit., 1992(b), 112.
9. Ibid., 115.
10. AERC, op. cit., 1990, 78.
11. Ibid., 66.
12. AERC, op. cit., 1992(a), 5.
13. Government of Pakistan, *Pakistan Economic Survey 1995–96*, (Islamabad, 1996), 130.
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15. AERC, op. cit., 1990, (iii).
16. Manning, Nick et al. *Devolution in Pakistan—Preparing for Service Delivery Improvements*, World Bank (Islamabad: World Bank, 2003).
17. AERC, op. cit., 1990, 58.
18. This Section makes use of a number of Government of Pakistan publications, such as: the *Explanatory Memorandum on Federal Receipts*, Federal Budget 2011–12, Government of Pakistan, Finance Division, Islamabad, 3 June 2011; the *Budget in Brief 2011–12*, Federal Budget, Government of Pakistan, Finance Division, Islamabad, 3 June 2011; the *Annual Review 2011*, the State Bank of Pakistan, Karachi, 2011; and *Fiscal Policy Statement 2010–11*, Debt Policy Coordination Office, Ministry of Finance (Islamabad, 2011).
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29. Khan, Mohsin, 'Comments', in V. Thomas et al. *Restructuring Economies in Distress* (Oxford: Oxford University Press, 1991).
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32. Ghaus, Aisha and Mohammad Asif Iqbal, 'Resource Mobilization by Provincial Governments', *News on Friday*, 25 August 1996.
33. Ibid.
34. Ibid.
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36. Applied Economics Research Centre, *An Analysis of Provincial Finances in Pakistan*, Research Report No. 55 (Karachi, 1986), 55.
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38. For a more detailed analysis of local government and its finances, see Zaidi, S. Akbar, 'Urban Local Government in Pakistan: Expecting Too Much From Too Little?', *Economic and Political Weekly*, vol. 31, no. 44, 1996; Zaidi, S. Akbar 'Urban Local Governance in Pakistan', in Islam, Nazrul and M. M. Khan (eds.), *Urban Governance in Bangladesh and Pakistan*, Centre for Urban Studies, University of Dhaka, 1997(a); Zaidi, S. Akbar, 'Poverty, Politics, Institutions: The Case of Karachi', *Economic and Political Weekly*, vol. 32, no. 51, 1997(b); and Zaidi, S. Akbar, *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999).
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42. AERC, op. cit., 1990, 14–16.
43. See AERC, op. cit., 1990; AERC, op. cit., 1991; AERC, op. cit., 1992(a).
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46. Ghaus, Aisha, op. cit., 1994, 89.

11 Debt and Deficits

For many years now, the role that the fiscal deficit has played in the economy of any country—whether developing or developed—has been one of the most talked about topics around which other economic issues have revolved. Academicians, policymakers and politicians have spent written extensive and numerous papers and reports regarding the problem of public debt and of the fiscal deficit. In the western developed countries, and especially in the United States, political campaigns, including the US presidential campaign, have had the growing fiscal deficit as one of the most important issues on which candidates were expected to have a clear policy position. Some years ago, Ross Perot, the independent candidate in the elections, made the deficit his principal issue and came up with a number of somewhat extreme 'solutions' to what is considered to be the US's major 'problem', which included an amendment to the US constitution making it obligatory to balance the budget each year, which was subsequently approved by the Congress in 1995. In 2013, the US Congress and President Obama were at loggerheads around issues of taxation, spending, and the public debt, having very different and divergent views and solutions to these problems. In Europe, too, the Maastricht Treaty for European unity includes a clause that requires fiscal 'discipline' by its members. The crisis in Europe, in Greece, Spain, Italy and Ireland after 2008, and particularly in 2011 and 2012, has shown the significant role of public finance, and of debts and deficits.

The general concern is that the existing levels of budgetary deficit are abnormal and undesirable, and many OECD countries have felt the need to follow budgetary strategies that attempt to reduce, and if possible eliminate, the entire deficit as soon as possible. The general consensus seems to be that these large current deficits are not sustainable, and that unless some forceful and direct action is taken, the deficits are likely to continue growing until they swamp the entire economy.

In the case of underdeveloped countries, the importance attached to fiscal deficits is even greater. The World Bank and the IMF believe that the fiscal deficit is the single most important policy variable that affects the rest of the economy, and they are able to express this belief through the implementation of their Structural Adjustment Programmes. As Willem Buiter, a leading academician who has carried out extensive work on the fiscal deficit writes,

> the International Monetary Fund lectures finance ministers and heads of central banks . . . as follows: public sector deficits, and especially increases in public sector deficits, are bad always and everywhere, regardless of circumstances, and discretionary spending cuts and/or tax increases should be implemented to reduce these deficits always and everywhere regardless of circumstances'.[1]

In the case of Pakistan, the fiscal deficit is seen to be the cause of almost all the ills facing the economy. Shahid Hasan Khan, Special Assistant on Economic Affairs to the Prime Minister of Pakistan during the second Benazir Bhutto government, had said that 'the fiscal deficit is the primary cause of all major ills of the economy. Consequently, any effort aimed at rehabilitating the economy would have the elimination of fiscal deficit as the number one item in its agenda.'[2] Every single IMF and World Bank document on Pakistan, especially since the Structural Adjustment Programmes of 1988, says exactly the same (see Chapters 16 and 17).

Given the substantial importance of the fiscal deficit, this chapter will try to identify the issues involved. We will first highlight some of the more general and standard theoretical arguments, and then examine the claim that fiscal deficits are always bad, regardless of the consequences. This chapter will also address the issue of the fiscal deficit in Pakistan, and will analyse whether it really is the primary cause of 'all majors ills of the economy'.

11.1 Does the Fiscal Deficit Matter?

Despite, or because of, the growing awareness and concern regarding budget deficits and public debt, there is a great deal of confusion about what the implications and consequences of large and/or increasing budget deficits really are. Do government deficits absorb private savings? Does public debt diminish private demand for stocks of productive capital assets? Can the burden of current government expenditure be shifted to future generations? Are inflations caused by deficits and public debt? Will government borrowing continue to raise interest rates? And will a tax cut mean bigger deficits while it stimulates aggregate demand, employment, and output, or will it have no real consequences whatsoever? These are some of the numerous themes and questions that reappear in the debate concerning public debt, which has been singled out as causing most of the serious problems faced by the economy. As James Tobin, an economist and winner of the Nobel prize in 1978, argues: 'few issues of economic theory and fact evoke such polar disagreement. The contesting views carry radically divergent implications for public fiscal and financial policy.'[3] Willem Buiter goes even further: 'probably more uninformed

Box 11.1

Pakistan's Fiscal Responsibility Bill

1. In order to address Pakistan's high debt and deficit problem, the government in October 2003 tabled the Fiscal Responsibility and Debt Limitation Bill 2003 in Parliament.

The government on Monday introduced in the National Assembly the Fiscal Responsibility and Debt Limitation Bill 2003 to make it binding on the government to bring down revenue deficit to zero by 30 June 2008, and maintain a revenue surplus thereafter.

Briefing reporters here on Wednesday about the Bill, Finance Minister Shaukat Aziz said the economic managers of the country will be made answerable to Parliament in case of any deviation from the set targets.

Transparency about public spending and borrowings will be ensured through comprehensive public disclosures, he said.

Under the law, a target has been set to reduce public debt to 60 per cent of GDP by the year 2013 and to keep cutting it by 2.5 per cent in subsequent years. He said the government guarantees to the public-sector entities would not amount to more than 2 per cent of GDP.

The minister said few countries in the developing world had taken such an initiative to control public expenditure.

He said deviations from the targeted expenditure could only be made in case of unforeseen demands on the finances of the government resulting from either a national security situation or a national calamity as determined by the National Assembly.

However, the finance minister would have to specify the reasons to the Assembly for making such a departure.

The government would be responsible to file three statements every year to the National Assembly, namely, the medium-term budgetary statement along with a three-year rolling target, the fiscal policy statement and the debt policy statement.

In the fiscal policy statement, the government would be required to submit key macro-economic indicators like total expenditure, total revenue, total fiscal deficit, revenue deficit and total public debt.

In the debt policy statement, the government would explain the set targets concerning debt strategy and say if these had been met, and if not, for what reasons.

The government would also submit the analysis of the foreign currency exposure of Pakistan's external debt along with evaluations of the cost of external and domestic debts.

The government would also be required to inform the National Assembly about any major economic decision which it might have introduced during the year but the minister said there was no definition of the major decision.

Under section 8 of the bill which deals with disclosure of policy decisions, the finance minister would not be bound to disclose information which he felt would prejudice the substantial economic interest of Pakistan, or the security or defence of Pakistan or its international relations. Information which might compromise the federal government in a material way in negotiations, litigation or commercial activity or which may result in material loss of value to the federal government, would also be not disclosed.

Both the minister and secretary of finance would give an undertaking about the authenticity of the information and data provided to Parliament.

If the government continuously fails to meet the target of debt to GDP ratio specified for any reason for two years, the government shall take all necessary measures including the curtailment of the sums authorized to be paid and applied from and out of the federal consolidated fund to return to the debt reduction path by the end of the next two fiscal years.

He said the government would be required to establish a debt policy coordination office comprising two non-government members and a director general who would work directly under the finance minister.

Asked as to why the provision relating to cut in the salaries of related officials in case of non-compliance with the set targets had been eliminated from the bill, the minister said that loss to the national interest or objectives could not be protected through salary cuts. He, however, said that no other punishment had been envisaged in the law which could be improved in the days ahead.

Source: *Dawn*, Karachi, 28 October 2003.

2. The following is an edited excerpt from the *Fiscal Policy Statement 2010–11*, Debt Policy Coordination Office, Ministry of Finance, Islamabad, 2011, about the Fiscal Responsibility and Debt Limitation Act 2005.

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 was approved on 13 June 2005. The FRDL Act, 2005 requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. Here we identify the various limits prescribed by the FRDL Act 2005.

The FRDL Act 2005 requires the following:

(1) Reducing the revenue deficit to nil not later than the thirtieth June 2008 and thereafter maintaining a revenue surplus. (2). Ensure 'that within a period of ten financial year, beginning from the first July 2003 and ending on thirtieth June 2013, the total public debt at the end of the tenth financial year does not exceed sixty per cent of the estimated gross domestic product for that year and thereafter maintaining the total public debt below sixty per cent of gross domestic product for any given year.' (3) Ensure 'that in every financial year, beginning from the first July 2003, and ending on the thirtieth June 2013, the total public debt is reduced by no less than two and a half per cent of the estimated gross domestic product for any given year, provided that social and poverty alleviation related expenditures are not reduced below 4.5 per cent of the estimated gross domestic product for any given year and budgetary allocation to education and health, will be doubled from the existing level in terms of percentage of gross domestic product during the next ten years.' (4) Not issue 'new guarantees, including those for rupee lending, bonds, rates of return, output purchase agreements and all other claims and commitments that may be prescribed, from time to

time, for any amount exceeding two per cent of the estimated gross domestic product in any financial year: Provided that the renewal of existing guarantees shall be considered as issuing a new guarantee.'

Since the last few years, Pakistan has been faced with serious challenges both at the domestic and international fronts. The serious internal security situation, energy shortages, rehabilitation of IDPs, severe floods, and rising inflation combined with global economic and credit crises and higher commodity prices, have all put enormous pressure on the government's limited fiscal resources. Given the severity of these constraints, the government has been able to manage the fiscal deficits at reasonable levels though was unable to totally comply with some provisions of FRDL Act 2005. However, the government remains fully committed to adhere to all the provisions of FRDL Act 2005 in the future.

Source: Debt Policy Coordination Office, *Fiscal Policy Statement 2010–11* (Islamabad: Ministry of Finance, 2011), 48–50.

statements have been made on the issue of public sector debt and deficits than on any other topic in macroeconomics. Proof by repeated assertion has frequently appeared to be an acceptable substitute for the more conventional methods of proof by deduction or by induction.'[4]

Given the extensive literature that has been generated over the last decade, it is not possible in our brief review to examine all the effects and consequences of large public debt and deficits. We present only a few themes which we feel are important, and attempt to do justice to them: We examine the issue of balanced budgets and the problem of measuring the deficit itself. We then look at themes related to the effect of the deficit on future generations and on issues regarding intertemporal equity and distribution. The macroeconomic concerns of fiscal deficits—inflation, crowding out, etc.—are discussed very briefly in Section 11.1.4, and in more detail with reference to Pakistan, below.

11.1.1 Should Budgets Always be Balanced?

Possibly, the converse of public debt and deficit is no debt and no deficit, i.e. a surplus, or at least a balanced budget. The argument is that, like households and firms, governments should also live within their means and not go into indefinite and extensive debt. But as Tobin argues, 'central government is different from other economic agents. It is entrusted with the ultimate taxing and monetary powers and responsibilities of society. Its horizon spans the generations.'[5] Hence, the analogy between households and nations living beyond their means does not really hold.

Alan Blinder and Robert Solow, writing four decades ago, before public debt in the United States had accumulated to the present levels, argued that 'at the crudest level, the desire for a steady government policy translates into a plea for an annually balanced budget. . . . The belief that government deficits (but not surpluses) are somehow wrong, lingers in the mind of many politicians.'[6] At the time they wrote, balanced budgets were not in vogue, but since then, there has been a demand by politicians in the US, that an appropriate way to maintain fiscal 'discipline' without stabilizing the economy would be 'to determine the level of government spending on its own merits, independent of the requirements of stabilization policy, and to set tax rates so as to produce a balance (or a small surplus) at full employment'.[7] The demand to legislate for balanced budgets constraining government activity was approved by the US Congress in 1995.

James Tobin, arguing against the balanced budget and tax limitation amendment which were first proposed in the US in the 1980s, takes a very clear stance. His focus was on the US Senate's resolution which would force future Congresses to balance every year's federal budget, and would limit the growth of federal revenues and outlays. In no uncertain terms, he says: 'to me it seems incredibly ironic that anyone would take this proposal seriously at this time. . . . The effects on the economy would be disastrous, converting the present depression into a great depression.'[8] Similar arguments have been made in the US and in Europe after the 2008 global recession, where economists have argued that these countries need a fiscal stimulus—more spending—not fiscal restraint.

Unlike a school of thought which insists that deficits are *always* bad, Tobin argues that federal deficits may even be economically *desirable* in specific circumstances, *and what is really important is appropriate public policy*, which may or may not produce a balanced budget. However, he argues that making deficits unconstitutional would increase economic instability. It would force ill-timed expenditure cuts or tax increases, which would then make recessions much worse. 'To force Congress to decrease expenditure or increase taxes to offset cyclical deficits would further depress the economy. The deficits perform a useful function in absorbing saving that would otherwise be wasted in unemployment, excess capacity, or lower production.'[9] Tobin argues that there are built-in stabilizers in the fiscal system which give it a sense of balance, but if there were a compulsion to balance the budget every year, these stabilizers would lose their efficacy. However, *the main focus for Tobin is sensible and appropriate public policy, rather than a fixation with the balanced budget*. This view is shared by Willem Buiter, who argues that 'optimal, or merely sensible, budgetary policy is bound to be characterized by systematic, predictable, and sometimes persistent departures from budget balance. Even in long run equilibrium, zero is not a uniquely interesting figure for the budget deficit.'[10] See Box 11.1 for Pakistan's Fiscal Responsibility Bill.

11.1.2 The Problem of Measuring Deficit

While concern about the deficit and the growing public debt has invoked substantial debate, there has also been a fair amount of discussion around the measurement of the debt and the deficit, and about which items constitute government assets and/or liabilities.

Robert Eisner and P. J. Piepper argue that conventional measures of fiscal deficit and debt are 'fundamentally flawed'. In their analysis they correct the figures for debt for changes in the market value of government debt due to changes in interest rates and changes in the real value due to inflation. They find these adjustments in measurement critical to their findings: 'failure to measure deficits correctly has not only contributed to a false view of fiscal impotence, but has possibly lead to an overestimate of the importance of money'.[11]

M. J. Boskins also questions the figure quoted for the officially reported deficit, which for him is a very poor indicator of the underlying public debt policies. He feels that there are 'very significant if not overwhelming difficulties of gauging the extent of true debt policies from official reports'.[12] For Boskins, the particular view of the federal financial picture depends critically on *what one chooses to include as a measure of debt and the deficit.* By making certain assumptions and adjustments, one can end up with very different figures for the deficit and debt, and thus one can make use of them to suit one's own particular goal. Despite the apparent cynicism in the context of measuring deficit and debt, there is a built-in warning which urges one to look beyond the very obvious, and examine the data and assumptions on which claims are being made. As Buiter argues, 'none of the (doctored or undoctored) deficit measures are reliable indicators of the magnitude or even sign of the effects of fiscal policy on interest rates, capital formation, or the capital account of the balance of payments'.[13] Food for thought, indeed! See Box 11.2 for definitions of the deficit.

11.1.3 Fiscal Deficits, Intertemporal Equity, and Distribution

T. Ihori asks the important question of whether increasing debt finance is adding an increasingly unfair burden on future generations. If the answer is in the affirmative, then one may conclude that present generations are benefiting by consuming services provided currently, while future generations will have to foot the bill; hence, one should not borrow. On the other hand, one may be able to argue that, by borrowing now, there will be greater intergenerational equity,

Box 11.2

Different Budget Deficits

Different figures for the budget deficit are quoted by different people due to the different definitions in use and also because of problems of measurement. Here we show how three different figures can be generated and used, depending on expediency.

Revenue budget surplus/deficit

A revenue surplus or deficit of the budget is equal to the difference between net revenue receipts and current expenditure minus the repayment of foreign debt. Net revenue receipts are equal to the gross revenues of the federal government minus the transfer to the provinces. The revenue surplus shows the extent of public sector saving, where a surplus implies positive saving by the government, and a deficit negative saving. This revenue surplus or deficit is the bridge between the revenue and capital account of the government. In the case of Pakistan, public saving has been negative for many years, thus a revenue deficit of the budget. An increase in the revenue budget deficit shows that the government is using its borrowings increasingly to meet current expenditure, especially the salaries of government employees.

Overall budget deficit

This is the most commonly used indicator to refer to the state of a country's public finances, and measures the difference between the total expenditure of the government and its resources. It measures current expenditure plus development expenditure minus repayment of foreign debt minus net revenue receipts minus the contribution by autonomous bodies minus the amount earned by disinvestment of shares.

The primary budget deficit

Usually budget deficits measure impacts of discretionary government policy. However, one important variable of the budget, i.e. debt servicing, is non-discretionary and is predetermined by the size and terms of previous budgeting decisions and loans. The primary budget deficit, by excluding the debt service, measures the impact of all discretionary changes of the government in any year. It is calculated by subtracting the interest payments on domestic and foreign debt from the overall budget deficit.

Source: Qazi Masood Ahmed and Hafiz Pasha, 'Definition, Measurement and Implications of Different Deficits in the Budget', unpublished manuscript, n/d.

Debt or deficit?

Few people seem to know the difference between debt and deficit, and use the terms interchangeably. The deficit is the amount by which expenditures exceed tax revenues in a given period or, in the more comprehensive official jargon, 'outlays' exceed 'receipts', and hence the amount that must be borrowed or added to the debt over the period. The debt is the amount owed at any point in time—what has been borrowed and not paid back. In the case of any country which has accumulated a large debt, even a dramatic decrease in the deficit over a few years will not decrease the nominal debt—it will, in fact, increase the debt. Only if there were a budget surplus would there be some decrease in the debt.

Source: Eisner, R., 'Sense and Nonsense about Budget Deficits', *Harvard Business Review*, May–June 1993.

since part of the cost of capital outlays will be passed on to the future. He feels that the answer to the question of whether debt is passed on to future generations depends critically on the definition of the burden of debt. F. Modigliani's definition rests on the assumption that a permanent increase in government debt would crowd out private investment in the long run, causing a net decrease in the capital stock. He calls this negative effect on the capital stock a burden of the public debt—that is, 'each generation "burdens" the next one by bequeathing them a smaller aggregate stock of capital'.[14]

Even though some arguments suggest that a growing debt that must be financed by increasing interest payments is unfair to future generations, it could, in fact, be argued that future generations are better off because of the manner in which the public debt is spent. If governments invest in improving the quality of life of present and future generations by investing in social goods like health, education, and infrastructure, future generations may actually be better off in real (and human capital) terms. However, if deficits grow due to massive increases in military spending (as in the case of Pakistan, discussed below) and large tax cuts, one could argue that the burden of debt on future generations (and on the present one) may not be very fair. Thus the nature of spending public money and who actually decides where it should be spent is a critical factor often ignored in a debate that has become obsessed by the *amount* of public expenditure.

11.1.4 Macroeconomic Implications[15]

The IMF and the World Bank are agreed on one point, that dealing with budget deficits is one of the most 'vexing problems' for the majority of underdeveloped countries, and hence fiscal policy is now an essential component of adjustment programmes, where fiscal 'discipline' and 'restraint' are viewed as prerequisites for macroeconomic stabilization (see, for example, the issues in Chapters 16 and 17). Many observers argue that the fiscal deficit is a useful indicator of overall economic performance, and have found 'a significant statistical relationship between the deficit and many, though not all, macroeconomic performance variables'.[16]

The budget deficit is held responsible for high inflation, low growth, a current account deficit, and the crowding out of private investment and consumption. The relationship between deficits and other macroeconomic variables is said to depend on how the deficits are financed. Simply put, this view holds that

> money creation leads to inflation. Domestic borrowing leads to a credit squeeze—through higher interest rates or, when interest rates are fixed, through credit allocation and ever more stringent financial repression—and the crowding out of private investment and consumption. External borrowing leads to a current account deficit and appreciation of the real exchange rate and sometimes to a balance of payments crisis (if foreign resources are run down) or an external debt crisis (if debt is too high).[17]

Researchers also find 'strong evidence' from empirical studies examining the role of underdeveloped countries which supports the claims made above.

Professor Robert Eisner, a leading proponent of the minority Keynesian view regarding budget deficits, argues that budget deficits do matter and their effects can be substantial, but 'the current size of the federal deficit [in the USA] is not "our number one economic problem", if indeed it is a problem at all'.[18] He cites data from the USA 'the world's largest debtor nation'—and shows that, despite a large and growing deficit in the 1980s, inflation, thought to be one of the key victims of large budget deficits, had declined sharply. In fact, he argues, 'the time-series relation between deficits and inflation in the United States has generally been negative; bigger deficits have come with less inflation and smaller deficits with more inflation'.[19] What is more surprising, and what contradicts conventional wisdom, is the relationship between the deficit and growth: empirical evidence shows how US deficits 'have over the last several decades proved stimulatory to the economy'[20]—the greater the deficit between 1955 and 1983, the greater was the next year's increase in GNP; and the less the deficit, the less was the subsequent increase in GNP. Budget deficits are seen to be related not only to the growth of GNP as a whole, but also positively to consumption and investment. Furthermore, there is evidence that 'deficits have not crowded out investment [but] there has rather been crowding in'.[21]

For the purposes of our analysis of Pakistan's fiscal deficit, we will be concerned mainly with the macroeconomic effects of the deficits. As the arguments above show, there is some disagreement over the macroeconomic implications of a large fiscal deficit. However, almost all conventional economists, especially those who work in and advise international agencies, particularly the World Bank and the IMF, argue that the fiscal deficit is bad and unwanted. They claim that the economy will suffer appreciably if the deficit is not removed, and for them, it is probably the single most critical statistic that determines the health of the economy. Let us now examine this role in the context of Pakistan.

11.2 Critical Concerns Regarding Pakistan's Fiscal Deficit[22]

If one single factor were to be identified on which the entire Structural Adjustment Programmes from 1988 to 2013 have been based, it would have to be the fiscal deficit (see Chapters 16, and 17). The reduction of the fiscal deficit is, without doubt, the key component of the adjustment programmes, and most other measures seem to revolve around this objective.

The World Bank in its reports on Pakistan's Structural Adjustment Programmes, has consistently emphasized the importance of debt reduction.[23] For the World Bank, Pakistan's long-term growth path and the government's attempts to make development sustainable would have been severely jeopardized if the large deficits had not been reduced in the mid-1980s, when they were more than 8 per cent of

GDP. Following the first of the major adjustment programmes in 1988, the World Bank concluded that 'the implementation of the adjustment program was weakest in the area of fiscal 24 and that the high fiscal deficit would *ultimately undermine growth and inflation objectives*, and put pressure on imports, worsening the current account deficit position.

The level of domestic debt outstanding between 1980 and 2012 is shown in Table 11.1. This debt has been funded by borrowing from both external and domestic sources, with greater reliance on domestic borrowing, particularly non-bank borrowing. By relying on non-bank borrowing, Pakistan avoided the inflationary effects seen especially in Latin America. The government was able to avoid printing too much money to fund the deficit, and kept external debt 'manageable'. However, the World Bank in the past has argued that

> this borrowing strategy [i.e. non-bank borrowing] is not the most efficient, from the point of view of cost-effectiveness of debt finance and flexible monetary management. Furthermore, it has negative consequences on the development of financial markets, because of the size of the debt, its large array of instruments and interest rates, and the credit ceilings imposed on commercial banks, to avoid inflationary consequences.[25]

In the past, the government has also been held responsible for relying on the 'high-cost' non-bank borrowing source, causing an increase in interest rates and hence crowding out domestic investment. On the one hand, the World Bank compliments Pakistan for avoiding the inflationary impact of the deficit, but on the other, it castigates it for having done so.

There are essentially three types of domestic debt (see Table 11.2). Floating debt is of a *short-term* nature; it includes cash credit by commercialized banks to the government for its working capital needs and constitutes ad hoc and regular Treasury Bills held by the State Bank of Pakistan and commercialized banks. In 2002/3 it constituted 49 per cent of the debt and was 54 per cent in 2012/13. All banks were required to keep 30 per cent of their deposits in government paper (the liquid assets requirement), most of which are in the form of Treasury Bills that are available on tap. *Medium-term* borrowings constitute *unfunded* debt, which is made up of voluntary savings schemes aimed at the general public, largely comprising the National Savings Scheme instruments. This part of the government debt accounted for 23.5 per cent of total debt and has high, usually tax-free, yields. The *permanent* debt of the government is the *long-term* debt; it constitutes long-term market loans with maturities of between seven and twenty years and is usually held by institutions such as insurance companies and commercial banks. Table 11.2 shows how permanent debt first rose and then fell, with floating debt falling. Total debt as a percentage of GDP more than doubled after 1980/1 but fell again later. After the introduction of open market operations, six-month Treasury Bills constitute the largest instrument of government debt, followed by Federal Investment Bonds, both of which are usually held by banks and other financial institutions.

One of the problems identified with the reliance on non-bank borrowing to finance the debt has been that the debt's maturity structure is short term, and since much of this debt can be cashed on demand, it is very liquid. The private sector prefers these investments because of easy liquidity

Table 11.1
Domestic Debt Outstanding: 1980–2013

	1980/1	1986/7	1990/1	1997/8	1999/2000	2001/2	2010/11	2012/13^P
Total debt (Rs. bn)	62.5	284.47	448.16	1,056	1,642	1,757	11,908	13,626
Total debt (% of GDP)	22.9	43.4	43.9	43.5	52.2	48.4	66.0	59.50

P: Provisional
Source: *Pakistan Economic Survey* (Islamabad: various issues); State Bank of Pakistan, *Annual Report* (Karachi: various issues).

Table 11.2
Domestic Debt Outstanding at End of Period: 1980–2013

Type of debt	1980/1	1987/8	1990/1	1992/3	1996/7	2001/2	2011/12	2012/13^P
% share in total debt								
Permanent debt	23.7	27.6	25.9	40.4	27.4	23.2	20	22.2
Floating debt	54.5	42.2	38.0	35.5	41.1	31.7	53	54.3
Unfunded debt	21.8	30.2	36.1	24.1	31.5	45.1	27	23.5

P: Provisional
Note: The figures in this table may vary from those in Table 10.24 as data sources vary.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues); State Bank of Pakistan *Annual Reports* (Karachi: various issues).

and also because the tax-free rates are usually higher than the alternative saving instruments available. Moreover, the return on this form of debt is not particularly lower than for long-term debt. The problem for the government, given the liquidity and maturity structure of the national saving schemes, is that it has to take large refunding operations on a continuous basis.

> More importantly, these features make it difficult to plan precisely the refunding levels needed. Under such conditions, unforeseen circumstances, such as the recent political and economic uncertainties that led investors to accelerate the withdrawal of funds from the National Saving Schemes, can also undermine the Government's ability to manage monetary policy. In those instances, when the Government cannot cover the public's demand by issuing additional debt, the authorities may be compelled to monetize part of the debt temporarily. Such policy would require allowing monetary financing to exceed its targets for a period of time, possibly without significant consequences. But potential problems could arise if the outflows are sustained or if they are very large.[26]

The World Bank and the IMF believe that, if Pakistan is to build long-term foundations for economic development, 'the fiscal deficit must be brought down to a sustainable level. A sustainable deficit is one which permits an acceptable level of economic expansion within a framework of price stability and debt accumulation comparable with reasonable domestic and debt servicing ratios.'[27] The figure for the budget deficit which is supposed to be sustainable and which does not cause the numerous ills—inflation, low growth, current account deficits, etc.—is believed to be 4 per cent of GDP. Table 11.3, does, indeed, show how debt servicing has been eating up a substantial and growing part of the economy, while Table 11.4 shows how the fiscal deficit continues to be funded, causing domestic and foreign debt to grow, which eventually needs to be serviced. Interest payments are now the largest component of the budget announced by the government each year. Some reasons why interest payments have been rising and why Pakistan continues to live on a high debt path, and its implications, are discussed in Chapters 16 and 17. Also see Box 11.3, which links the issue of taxation with the debt and deficit.

Based on the large number of tables on the public finance structure presented in Chapter 10, and particularly those related to key variables, such as total expenditure, defence and development expenditure, interest payments, and the extent and trend of the public debt, we can summarize the main features of Pakistan's public finances and fiscal deficit as follows: These patterns have prevailed for many decades now. (Since debt and deposits arise out of taxation and expenditure readers are recommended to revisit Chapter 10 and look at the data, graphs, and trends shown there).

1. Total expenditure exceeds total revenue, and the growth in expenditure is greater than that in revenue.
2. Current expenditure alone exceeds total revenue.
3. Development expenditure has been falling, while current expenditure for the most part, has grown.
4. Defence expenditure has been very high, and much higher than even development expenditure, and although It shows signs of falling in recent years, this is due to accounting gimmickry more than anything else.
5. Interest payments along with defence expenditure constitute more than half of annual expenditure.
6. The main source for financing the fiscal deficit has been non-bank borrowing, rather than bank borrowing.
7. Domestic debt is greater than foreign debt.
8. The financing of the deficit is substantially from domestic sources rather than from foreign sources.
9. The fiscal deficit of the government of Pakistan had been around 8 per cent of GDP for much of the 1980s, fell in the 2000s under Musharraf due to the fiscal space created after ~~9/11~~—see Chapter 18—but rose again after 2007 and in 2012/13, was closer to 9 per cent of GDP.

Moreover, Table 11.5 shows some interesting trends since 1980, which are also worth highlighting.

1. Total revenue remained, with some variations over time, more or less the same for about two decades despite reforms of different sorts. However, as the economy has grown after 2002, the trend rate of total revenue has fallen.
2. Total expenditure has fallen, since 1980/1 to relatively lower levels since 1999 compared to the 1980s.

Table 11.3
Debt Servicing: 1983–2012 (% of GDP)

	1983/4	1986/7	1990/1	1996/7	1999/2000	2001/02	2011/12
Interest on domestic federal debt	2.0	2.8	3.5	5.2	6.7	5.2	4.1
Interest on foreign debt	1.2	1.3	1.4	1.2	1.5	1.7	0.3
Repayment of foreign debt	2.1	2.1	2.1	4.1	3.1	4.5	0.7
Total debt servicing	4.4	4.2	7.2	10.8	11.8	11.9	5.7

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues); State Bank of Pakistan, *Annual Reports* (Karachi: various issues).

Table 11.4
Sources of Financing the Fiscal Deficit: 1978–1995

	1978/9	1979/80	1980/1	1981/2	1982/3	1983/4	1984/5	1985/6	1986/7	1987/8	1988/9	1989/90	1990/1	1991/2	1992/3	1993/4	1994/5
Million rupees																	
Financing (net)	17,315	14,663	14,618	20,992	25,654	25,147	36,777	41,644	46,710	57,563	56,879	56,060	89,193	89,970	107,525	92,179	103,405
External (net)	6,711	6,951	6,977	5,345	5,162	5,001	5,169	8,584	8,424	12,691	18,195	22,945	22,101	18,022	24,334	24,624	37,299
Domestic non-bank	2,108	1,407	5,286	6,313	14,368	12,280	12,873	29,962	27,371	30,931	37,865	29,581	23,724	–515	19,972	55,048	47,626
Banking system	8,502	6,305	2,355	5,516	6,124	7,866	18,735	6,098	10,915	13,941	819	3,534	43,368	72,464	63,219	12,507	18,551
Distribution by source (%)																	
External	38.7	47.4	47.4	25.5	20.1	19.9	14.1	20.6	18.0	22.0	31.9	40.9	24.8	20.0	23.0	27.0	36.0
Domestic	61.3	52.6	52.3	74.0	79.8	80.1	85.9	79.4	82.0	78.0	68.1	59.1	75.2	80.0	77.0	73.0	64.0
Non-bank	12.1	9.6	36.2	30.0	56.0	48.8	35.0	71.9	58.6	53.7	66.6	52.8	26.6	–	19.0	60.0	46.0
Banking system	49.2	43.0	16.1	44.5	23.8	31.3	50.9	7.5	23.4	24.3	1.5	6.3	48.6	80.0	58.0	13.0	18.0
Banking systems's budgetary support as % of GDP	4.4	2.7	0.8	1.7	1.7	1.9	4.0	1.2	1.9	2.1	0.1	0.4	4.3	6.0	4.7	0.8	1.4

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

3. Although total expenditure has fallen, current expenditure actually rose considerably in the 1990s, although has fallen significantly since 1999.
4. Since a high degree of debt was accumulated in the 1980s, debt servicing increased over time. The highest proportion ever, 8.3 per cent of GDP, was paid out in 1999/2000, although as Chapter 18 shows, Pakistan's debt problem was suddenly and significantly 'resolved' after 9/11 and the beginning of the War on Terror.
5. Defence expenditure has fallen over time, although due to changes in the composition of what constitutes defence expenditure, one needs to be cautious about making absolute claims—see Box 11.4.
6. Development expenditure has fallen very dramatically from a high of 9.3 per cent of GDP in 1980/1 to around 3 per cent in the early 2000s, despite ample fiscal space; according to the *Pakistan Economic Survey* for 2011/12, it was a mere 2.1 per cent in 2000/1 perhaps the lowest ever, although the same source shows that for 2011/12, it was probably even lower.
7. The budget deficit had been brought down to early 1980 levels, but began to rise quite dramatically after the mid-2000s.

There seems to be complete agreement amongst many Pakistani economists and contributors in the press over the claim that the federal budget deficit is the most important threat facing Pakistan's economy.[28]

Fiscal policy has been identified as a 'critical failure' in the context of Pakistan, and as one of Pakistan's key macroeconomic problems, threatening price stability, balance of payments, 'constraining essential government investment in economic and social infrastructure, and thereby, endangering growth prospects'.[29] See Appendix 11.1 for a particularly forceful presentation of this view.

The persistent reference to the 'high and unsustainable' fiscal deficit by the IMF and World Bank (and sundry other commentators)—'the fiscal deficit has been perceived as a continuing problem in Pakistan'[30]—since at least the early 1980s, when the first Structural Adjustment Programme was initiated on the recommendations of the IMF, must rest on the premise that the budget deficit is responsible for most of the macroeconomic ills in the country, and thus, needs redress. The IMF, following the conventional wisdom which it has helped frame, would, in all likelihood, hold the deficit in Pakistan responsible for some, if not all, of the following consequences: growing inflation, crowding out of private investment, a falling growth rate, and the twin of the budget deficit, the continuing deterioration of the current account deficit. We must assume that, unless it was seen as a primary cause of the problems in the economy, it would not form the central tenet of policy statements and adjustment programmes that Pakistan continuously undertakes (also see Chapters 16 and 17). Let us examine some of the evidence.

Table 11.6 presents a summary picture of Pakistan's key macroeconomic variables over a long period of time, and it is worth examining trends particularly since 1980. The budget deficit as a percentage of GDP is presented alongside

Box 11.3

Taxation and the Fiscal Deficit

M. Sharif shows how problems in Pakistan's taxation lead to problems of expenditure choices and the fiscal deficit.

The most crucial issues pertaining to giving a boost to the country's tax revenue collection is making the overall tax regime equitable, reducing dependence on indirect taxation, and increasing direct taxation. The national leadership and the FBR have uphill task in addressing these issues in the next budget as the repercussions of not executing tax reforms would be severe for the country and its citizens.

There is a widespread consensus among stakeholders that all incomes including agriculture, big businesses, and real estate ought to be taxed in making the tax system more equitable and fair. According to the central bank, during the last fiscal year the agriculture sector generated Rs. 3.016 trillion, slightly lower than the amount generated by industrial sector. The latter contributes around 18.0 per cent in tax revenue through different layers of taxation whereas contribution of the agriculture sector is hardly 1 per cent. Similarly, according to FBR estimates there are 2.3 million potential taxpayers with a taxable income. Out of these, 0.7 million people fall in the higher income bracket but do not possess a national tax number. FBR officials also complain that the commercial banks do not cooperate with them to detect concealed incomes with the result that out of 30 million account holders, there are only 2.9 registered income taxpayers. All these hitches will have to be sorted out in case the government is serious about increasing tax revenue and tax-to-GDP ratio.

The second central matter with respect to fiscal reforms is of reducing the uncontrollable fiscal deficit. The existing strategy of reducing the deficit by making substantial cuts in public development expenditure, burdening power and oil sectors with taxes, pursuing a tight monetary policy, and opting for indiscrete bank borrowing have culminated in slow economic growth. A more practical option to trim down the deficit would be to cut down the subsidies provided to unproductive state-owned enterprises that equals to Rs. 350 billion per year, eradicate corruption within the tax administration that costs the public exchequer around Rs. 700 billion annually and reduce the cabinet's expenditure that is Rs. 100 billion a year. The ruling elite has no choice but to implement strict austerity measures and demonstrate strong financial discipline if reducing the surging fiscal deficit is on its economic agenda. Otherwise the country will have to rely upon foreign assistance to bridge the huge fiscal gap that prevails in the country.

In the last three budgets, the government could hardly formulate a viable growth strategy because of its pre-occupation with the SBA programme. The end result was that the economy ended up with a deplorable growth rate, heightened fiscal deficit and rampant inflation. The ground reality hardly matches the objectives laid down at the initiation of the SBA programme. The present situation clearly reflects that a sustainable growth strategy cannot be pursued unless pivotal financial reforms are put in place that should focus on enhancing tax revenue and cutting

Sharif, M. 'Fiscal Policy Reforms and Growth Strategy', *The News*, Karachi, 9 May 2012.

other variables which it is supposed to affect. Let us consider growth. The 'very high', 'escalating' budget deficit, according to the IMF theory of causality, should have had severe repercussions on the growth of the economy. This has clearly not always been the case. Pakistan has experienced very high growth rates compared to other developing countries and averaged well over 6.5 per cent per annum in the 1980s. This is no mean achievement given the huge budget deficit, which has averaged 7 per cent in the same period. Surely, the numbers must give pause for thought.

The inflation rate is another key variable that should have exploded given the high budget deficit. An average of only 7 per cent inflation over a decade is quite creditable. Moreover, only 9 of the 26 years between 1980 and 2006 have seen double-digit inflation, with a maximum of 13.9 per cent. According to estimates, Pakistan's inflation rate should

Table 11.5: Summary Fiscal Policy Statistics (% of GDP)

	Total Revenue	Total Expenditure	Current Expenditure	Debt Servicing	Defence Expenditure	Development Expenditure	Budget Deficit
1980/1	16.9	22.9	13.6	2.1	5.5	9.3	5.3
1980s average	17.3	24.9	17.6	3.8	6.5	7.3	7.1
1980s highest	18.6	26.7	20.3	5.4	7.0	9.3	8.7
and lowest	16.0	21.9	13.7	2.1	5.5	6.3	5.3
1990s average	17.1	24.1	19.4	6.8	5.6	4.7	6.9
1990s highest	19.2	26.7	20.5	7.6	6.7	7.6	8.8
and lowest	15.8	22.0	18.5	4.9	4.9	3.4	5.6
2000s average	14.2	18.7	15.4	4.9	3.2	3.4	4.5
2011/12	12.8	19.6	15.5	4.5	2.5	3.7	6.8

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Box 11.4

Exactly How Large is the Defence Budget?

Sakib Sherani examines the size of the defence budget announced in the 2012–13 budget in June 2012, showing that that the figure which is announced, usually under-reports the actual size of the defence budget, by a considerable margin.

One of the most scrutinized and commented upon items in the budget is the allocation for defence spending. Depending on the ideological leanings of those doing the commentary, the number is either 'too high' or 'too low'. The more dominant narrative, however, has been that the budgetary allocations for the defence sector leave little fiscal or policy space for civilian governments by 'crowding out' much-needed spending on the social sectors. It is an important issue that needs an unbiased examination.

While the budgetary allocations for 'defence' have been made far more transparent in the past few years than ever before, with an unprecedented break-up between personnel-related expenses and operating expenses etc.—which is not available in the case of many countries, including regional ones—the complete allocation still remains shrouded in mystery. This is so because, not unlike the global 'best practice', defence spending is spread over a number of different heads in the budget—with parliament and the media usually focusing on the largest item, 'defence affairs and services'.

The other expenditure heads contain relatively smaller, but not insignificant, amounts and include, for example, allocations for payment of 'legacy expenditures' incurred for upgradation of conventional capability, or to finance military operations in the northwest, or a non-civilian component of the public-sector development programme (PSDP). Another example of an item related to the defence budget but subsumed under a different head is 'debt servicing' of military loans (amounting to Rs. 4bn in 2010–11).

All told, I estimate this year's budgetary allocation for the defence sector to be around Rs. 800 bn, or approximately 28 per cent of the total budgeted expenditure. This figure includes military pensions, but excludes other security-related spending that falls under 'civilian' armed forces' (such as Rangers and the police). It is important to emphasize that this is an approximation since I have used a past estimate of the non-civilian component of the PSDP. On its own, the non-civilian component of the PSDP is not a very large item, accounting for under 10 per cent of the total allocation, with projects in the nature of construction of barracks, or building schools in cantonments etc. An important caveat is that the figure arrived at is the gross allocation for defence-related spending. For the past several years, sizeable inflows have occurred under 'defence receipts' (mostly relating to inflows under the Coalition Support Fund), which have provided an important offset to the recourse to budgetary resources by the armed forces. These payments are provided as reimbursements for expenditures already incurred by the armed forces for deployment and operations in the northwest.

Hence, on a net basis, after netting off gross expenditure with receipts, the total estimated allocation for the defence sector in the 2012–13 budget amounts to Rs. 679 bn. This is equivalent to 21 per cent of the total budget outlay, or 2.9 per cent of projected GDP. Most discussion of defence spending is restricted to the issue of the size of the expenditure outlay. An important question that needs to be examined in any balanced discussion is: what are the implications for the wider economy (the externalities) of expenditure of this quantum?

While I have not done such an analysis, one can list the possible areas of spill over. These would include direct and indirect stable employment for a significantly large pool of people and its associated spending effects (with the value of this factor increasing in times of severe economic uncertainty), income support to over a million families via pensions and the multiplier effect of substantial spending on civil works and other infrastructure, especially in remote areas where much of this activity occurs. On the flip side, if defence expenditure is displacing resources from spending on development, the trade-off for society needs to be worked out. A critical factor in any such exercise is determination of the 'optimum' level of defence spending for a country facing multiple security as well as developmental challenges. This is where broader issues related to defence spending come in, beyond the size of the defence budget.

These broader issues relate to transparency of spending by the defence sector, its accountability, and civil-military shared oversight. A related—and thorny—issue is determination of the 'threat perception' that generates the armed forces procurement plans. Currently, these areas are the sole prerogative of the security establishment in Pakistan. On all these issues, far more progress has to be made to optimise the defence sector budget, and to reduce the significant waste and corruption that occurs in the procurement process—from purchase of ordinary everyday supplies, to land for real-estate development, to the procurement of expensive weapons systems and platforms.

The submission of the defence budget with greater details to the parliamentary standing committees, and a threadbare in camera discussion, will be an important starting point. Equally important, two other steps need to be taken: (1) the application of PPRA (public-sector procurement) rules on any substantive procurement by the defence sector; and (2) the extension of the jurisdiction of the auditor general of Pakistan to entities such as the Frontier Works Organization and National Logistics Cell, for starters.

Finally, another issue involving the armed forces relates to economic governance. There are at least two areas of the economy where the military has direct stakes and can play a more positive role: ensuring that real estate is brought more effectively into the tax net (something it has resisted in the past on account of being one of the larger developers in the country), and ensuring that smuggling across the border with Afghanistan, where personnel of the armed forces are deployed and which has damaged the economy very substantially, is drastically contained.

In conclusion, the defence budget is not as large as it is purported to be, in net terms. In addition, it has certain important externalities (positive spill-overs) into the wider economy. Nonetheless, it suffers from a lack of parliamentary debate, transparency, accountability and civilian oversight.

Source: Sherani, Sakib, 'The Defence Budget', *Dawn*, Karachi, 15 June 2012.

Table 11.6
Gross Domestic Product, Inflation, Current Account Deficit, and Budget Deficit

Years	Growth rate (%)					As % of GDP		As % of GDP					
		Investment				Investment							
	GDP	Public	Private	CPI	CAD	Public	Private	CAD	Defence exp.	Develop. exp.	Interest payments	Budget deficit	PBD
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1960s	6.8	14.0	20.9	3.8	–	–	–	–					
1970s	4.8	25.3	17.0	12.3	–	9.2	7.2	–	–	–	–		
1980s	6.5	10.6	15.0	7.3	21.2	8.6	7.3	3.7	6.5	7.2	3.8	7.0	–
1990/1	5.6	20.9	19.2	12.7	14.8	8.3	8.7	4.8	6.3	6.4	4.9	8.7	3.8
1991/2	7.7	23.2	30.3	10.6	–33.0	8.6	9.7	2.8	6.3	7.5	5.2	7.5	2.3
1992/3	2.3	14.5	13.4	9.8	174.0	9.0	9.9	7.1	6.5	5.7	5.9	7.9	2.0
1993/4	4.5	7.1	11.6	11.3	–46.7	8.3	9.5	3.8	5.9	4.6	5.8	5.9	0.1
1994/5	5.1	18.9	8.5	13.0	26.4	8.3	8.8	4.0	5.6	4.4	5.5	5.6	0.1
1995/6	6.6	13.0	18.7	10.8	84.2	8.2	9.0	7.2	5.6	4.4	6.3	6.5	0.2
1996/7	1.7	–5.3	19.6	11.8	15.9	6.8	9.4	6.2	5.2	3.5	6.6	6.4	–0.2
1997/8	3.5	–14.9	13.3	7.8	50.1	5.2	9.6	3.1	5.1	3.9	7.6	7.7	–0.1
1998/9	4.2	25.8	–11.4	5.7	26.4	6.1	7.9	4.1	4.9	3.4	7.5	6.1	–0.5
1999/2000	3.9	5.5	14.3	3.6	–52.9	5.6	10.4	1.6	4.0	2.2	6.9	5.4	–1.5
2000/1	1.8	11.1	7.2	4.4	–55.1	5.7	10.2	0.7	3.2	1.7	6.0	4.3	–1.7
2001/2	3.1	–22.2	17.3	3.5	360.8	4.2	11.3	+1.9	3.4	2.9	6.2	4.3	–0.9
2002/3	5.1	–6.6	9.2	3.1	136.5	3.6	11.2	+3.8	3.3	2.2	4.9	3.7	–1.2

CAD = Current account deficit PBD = Primary budget deficit (budget deficit minus interest payments).
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

have averaged in excess of 50 per cent, given the high and unsustainable budget deficit.[31] With Latin American deficits, Pakistan has continued to have South Asian rates of inflation. Interestingly, however, in the early 1990s when the budget deficit was 8.7 per cent, after which it fell, inflation actually *rose* in this period. It seems that there might even be an inverse relationship between the two, at least in the case of Pakistan. Moreover, the persistent rise in inflation to double-digits after 2007/8, is not attributable to the fiscal deficit, which was actually quite low, but due to rising international oil and food prices, as well as to a devaluation of the Pakistani rupee. Mismanagement of the economy, in the interim set-up at the end of 2007 up to March 2008, and then the way the People's Party government mismanaged and bungled economic policy all the way from 2008 to 2013, was also responsible. However, importantly, there seems to be no evidence which links Pakistan's fiscal deficit with its inflation rate.

The crowding-out phenomenon is a key favourite of orthodoxy and neoclassicists, given their penchant for the private sector. The theory suggests that the government, in its financing of the deficit, would have pushed up interest rates to such an extent that the private sector would have found it unaffordable to invest, and thus would have been crowded out. This would have implied a growth rate of far less than the hugely impressive 15 per cent per annum experienced by the private sector in the 1980s. Moreover, with the even greater 'burgeoning of the budget deficit' in 1990/1 (8.7 per cent), 1991/2 (7.5), and 1992/3 (7.9), one would not have expected the 19, 30, and 13 per cent growth in the private sector over the same years. Clearly, there seems to be little truth in the claim that the private sector has been crowded out due to government policies or the budget deficit. The evidence, no matter how superficial, points to different conclusions. Moreover, in the period since 1988 when the deficit has been particularly high, so much so that the Structural Adjustment Programme of 1988 emphasized the need to cut the deficit drastically—and has continued to do so after the 2008 IMF Agreement—the economy has behaved even more unconventionally with respect to IMF theory: real per capita GDP rose by 10.4 per cent between 1988 and 1992; merchandise exports expanded by an average of 14 per cent per annum in volume; private sector gross fixed capital formation gradually expanded from 7.7 to 9.4 per cent of GDP; and even domestic savings rose from 10.5 to 12.2 per cent[32] (see Chapter 7 for why growth was so high in this period). Furthermore, even the current account deficit behaved quite contrary

to IMF theory. In the later 2000s, especially after 2007/8, it was the consequences of the War on Terror, the militancy in Pakistan, the transition from a military dictatorship to democratic rule, as well as the international crises and price rises, which caused Pakistan's economy to come undone—see Chapter 18. It was not the fiscal deficit which was responsible for these problems. With this evidence, one is forced to re-examine the questions: does the budget deficit matter in the context of Pakistan and how does the IMF/World Bank feel about this issue?[33]

11.2.1 The IMF/World Bank View of Pakistan's Fiscal Deficit, 1980–97

Given its repeated concern over the issue of the budget deficit, one is led to believe that the IMF has views on Pakistan's budget deficit consistent with its theoretical construct. Not so. The IMF/World Bank admit that

> the macro consequences of fiscal deficits in Pakistan have apparently been quite dissimilar from those in other developing countries with fiscal deficits of comparable magnitude. *Specifically, Pakistan has experienced neither hyperinflation nor debt rescheduling. . . . Growth has remained quite strong through the last two decades, inflation has not been high, and the current account deficit has averaged about 2 per cent of GNP, remaining largely financeable and not posing debt servicing problems for the country.*[34]

These institutions, despite their insistence on the need to lower the deficit, admit that the deficits have been 'quite benign' and that, despite the presence of fiscal deficits 'that are *very high* by international standards, the country's macroeconomic performance has been relatively good. . . . *There is no evidence in Pakistan of the chronic acute macroeconomic crises*—manifest in extended periods of negative per capita income growth, hyperinflation, and inability to service external debt—that have characterized many other developing countries with comparable fiscal performance.'[35]

The institutions that insist on cutting down the deficit admit that 'inflation performance in Pakistan appears to have been remarkably good. . . . At the same time economic growth has been robust',[36] and real GNP per capita between 1972 and 1987 has shown a cumulative increase of more than 60 per cent. Additionally, even the crowding-out argument seems to have been rejected, albeit reluctantly, with the IMF/World Bank admitting that public and private investment seem to be positively correlated and 'the infrastructural build up that results from government investment appears to facilitate private investment'.[37] Public investment was reduced drastically after 1996/7 as a consequence of privatization and with restraints on government spending, while private investment turned negative after the 1998 nuclear tests—see also Chapter 18.

A study conducted by the IMF on determinants of private investment in Pakistan argued that aggregate government investment had a significant positive impact on private investment, implying 'that the crowding-out effect was not strong enough to balance the crowding-in effect in the period covered [1972–88] and is consistent with the view, inter alia, as to the importance of upgrading the country's roads and transportation networks, and improving the drainage system'.[38] This government investment in infrastructure was 'estimated to be *the most important positive determinant*' of private investment in the period covered. The investment in infrastructure is expected to continue to have a '*significant* crowding-in effect' in the future. Interestingly, similar conclusions have been reached for India as well, based on an evaluation of past trends. Significantly, after 1996/7 when public sector investment was cut drastically, private investment also fell, accentuated by the consequences of the nuclear tests. As Chapter 8 shows, since public sector investment has fallen sharply over the last decade, so too has private sector investment.

The IMF believes that the deficit has not behaved in Pakistan as it should have in this period, for several reasons:

1. There was a very high rate of growth of real output (6 per cent per annum) which permitted a fairly rapid expansion of both interest-bearing and non-interest-bearing debt without recourse to inflationary finance.
2. The equilibrium deficit was quite high—5.5 per cent of GNP—despite a low inflation rate because of a very high underlying rate of growth of real output.
3. The government of Pakistan was able to borrow, both domestically and externally, at rates below the marginal cost of funds in the international private capital markets.[39]

In addition, throughout the 1980s, the budget deficit was not monetized, and external funds and non-bank borrowing were the main sources of funds to finance the deficit, so inflation remained low. It was only after 1990/1, when bank borrowing contributed a very large share of the financing of the budget deficit, that inflationary pressures emerged. However, after 1993/4 bank borrowing returned to the low, pre-1990 level.

Our own observations regarding the impact of the budget deficit on key macroeconomic variables question the economic orthodoxy with respect to Pakistan, as do the observations and findings of IMF staff and IMF-sponsored studies. While the monetarist neoclassical assumptions and predictions regarding the behaviour of the budget deficit are clearly spurious, if not outrightly rejected, the Keynesian interpretations, where public spending causes an increase in aggregate demand and, subsequently, growth, given the less than full capacity of the economy, seem somewhat closer to reality. The greater the public expenditure, the greater the rate of growth of GDP and the greater the private investment. Moreover, since there is no crowding out through the mechanism of the interest rate as predicted by theory, one is led to believe that there are ample loanable funds available at a given interest rate. Easterly and Schmidt-Hebbel, in their review of developing countries, found that private investment does not respond much to interest rates.[40] As has been argued extensively elsewhere,[41] the evidence suggests that Pakistan's economy had been in far better shape for the duration of the Structural Adjustment Programmes than the IMF/World Bank believed. Whether this was due to the huge underreported informal economy or to any other factor

is open to debate. In fact, it is interesting to note that, if indeed it is true that Pakistan's GDP is under-reported by as much as 40 per cent,[42] then the size of the budget deficit as a percentage of the true GDP would be much less than the reported official figure of 8 per cent and the present figure may even be 'sustainable'. Although this is a debatable and controversial point, it may nevertheless be the key in answering the question of why the deficit has, continued to remain 'benign', and did disrupt the positive trends in the economy as it should have. Given the nature and robustness of the economy, a fact conceded even by the IMF, it seems quite clear that, in the conventional orthodox framework, *the budget deficit may not be the real culprit after all.*

11.2.2 Re-examining Critical Concerns

Having just argued that the budget deficit, in the conventional orthodox neoclassical framework, does not matter with regard to Pakistan, we will now argue that it is perhaps the most important statistic around which debate *ought* to take place. However, we take this view for very different reasons from the IMF and World Bank.

The obsession that policymakers in Pakistan have with the budget deficit detracts attention from the really important issues. The focus should not be on asking the question: how high is the budget deficit, and is it sustainable? The real concern regarding the deficit is the issue of *spending and redistribution*. It is more important to ask the questions: What use is being made of public money? Who is funding government expenditure, i.e. who is being taxed? How is public expenditure managed? And so on.

Tables 11.5 and 11.6 again provide a very brief overview of what we feel is the central issue regarding the budget deficit: The contrast in the patterns of defence expenditure and development expenditure is the key concern regarding the budget deficit and public spending. In fact, Pakistan might well be the only underdeveloped country where defence spending has outweighed development expenditure. Since 1980, development expenditure has fallen far sharply than the small reduction in defence expenditure. Moreover, between 1985–1995, defence spending increased by 150 per cent, compared to an 89 per cent increase in development expenditure. Ironically, prior to 1985–6 when there was a military government in power and Pakistan was under martial law for most of the time, defence expenditure was considerably lower than development expenditure. After the advent of democracy in Pakistan, between 1988–1999 defence spending was higher than development expenditure in every single year, except one! There are two possible explanations for this pattern: according to one view, during military rule, not only was the military making direct use of the defence budget, but also, due to its status as 'the government' and due to various privileges, it acquired a large share in the civilian side of the economy. Thus, in real terms, defence expenditure was just a fraction of the extent to which the military really benefited.[43] This also explains why the primary budget deficit was higher in the 1980–6 period (averaging 3.6 per cent) than in the 1986–93 period when it averaged 1.9 per cent.

A second explanation for this trend is that in the post-martial law period, while the military was not *in government*, there is little disagreement that the military continued to be *in power*. Furthermore, given democracy's inability to deal with political problems in Pakistan, the military played a more overt policing role. Therefore, a high share is given to defence expenditure—and a smaller residual share to development—under democracy.[44]

If the budget deficit is 'the number one problem of Pakistan's economy', as most observers believe, it is for reasons connected with the role and distribution of public expenditure, and is not dependent on the fetish of an abstract, arbitrary, badly calculated statistic. The question of governance, or how public money is utilized, allocated, managed, and siphoned off, is of critical importance. With corruption rampant at all levels of government, and with political power being bought and sold in different provincial and national governments in the past, it is clear that the taxpayer's money continues to be used to buy off opposition and keep dissent under control. Unquestionably, the specific context of fiscal policy and budgetary deficits is all important (see also Box 11.5 and Appendix 11.2).

11.3 The Domestic and Foreign Debt Crises

General Pervez Musharraf set up a Debt Reduction and Management Committee in January 2000, to tackle Pakistan's serious problem of external and internal debt, which had grown to a size greater than that of the GDP. Unlike many other countries which had either a foreign debt problem or a domestic one, Pakistan was in that category which faced a serious crisis on both fronts, domestic and foreign. As a consequence, the Committee released a report called the Debt Reduction and Management Strategy[45] (DRMS), which laid down the causes for the excessive debt and numerous possibilities and solutions to alleviating that debt. During 1999–2000, after the nuclear tests of May 1998 and following the military coup, Pakistan was besieged with a far greater proportion of problems than what we had become used to in the past—see also Chapter 18 for the background of events leading up to these problems. For much of the decade of the 2000s it seemed that at least the external debt crisis had been resolved partially after an unprecedented debt rescheduling package—see Chapter 18. And since pressure had been lifted off the external debt situation, this should have allowed great deal of fiscal space to address issues of domestic debt as well. For quite exceptional, extraneous, reasons not related to Pakistan's Debt Reduction and Management Strategy, considerable pressure had indeed been lifted off the debt crisis. This section of this chapter, examines the extent and reasons for Pakistan's extraordinary debt profile prior to the debt rescheduling that took place.[46]

Writing in 2001 when no one could have imagined that in a few months time Pakistan's debt profile would change drastically on account of its foreign debt being rescheduled, the DRMS stated: 'Pakistan's public debt has

Box 11.5
Fixing Targets for the Budget Deficit

In this excerpt, we examine whether having a fixed target for the budget deficit for Pakistan is a wise policy move or not.

If the government's deficit is used for stepping up public capital formation, then not only does it stimulate the economy from the demand side, but also it keeps relaxing the economy from the supply side, both through its direct effect on the magnitude of capital stock and through its indirect effect via stimulating private investment. On the other hand, if the increase in the government's deficit is confined to non-capital expenditure then revival of the economy would necessarily be brief and evanescent, since such a revival would fairly soon run into an inflationary barrier.

This consideration is particularly important for an economy where agriculture accounts for a major part of the consumer goods sector. It may, for instance, be argued that *any* government expenditure (even non-capital expenditure), by stimulating the economy, would call forth private investment via accelerator effects, so that the inflationary barrier would keep getting pushed back: this argument, however, would certainly not hold in the case of agriculture. Private investment in agriculture is not governed by any version of the acceleration (or capacity utilization or even profit) principle. It depends essentially upon the availability of complementary inputs like supra-individual irrigation facilities, power, extension facilities, seed-fertilizer packages, etc. whose provision is contingent upon public investment effort. In short, in an India-type economy it is not just any expansion in the government's deficit which can trigger off a sustained boom, but an expansion that takes the form of a larger investment effort. And this is precisely what the last two years' deficit expansion has not been used for.

It seems that Budget '96 is going to revolve around one single figure—4 per cent. All indications about the deliberations underway at different levels of government in the build-up to the new budget suggest that Islamabad is going to do its utmost to bring the deficit down to 4 per cent of GDP. One of the key indicators which the government has specifically tried to control, the budget deficit, seems to have grown in importance over the last few years. In the coming financial year 1996/7, it will probably become the government's obsession, having extensive ramifications on a number of areas of the economy.

As far as raising revenue is concerned, despite the numerous tax measures taken each year to increase overall revenue—essentially by imposing a heavier burden on those who already pay taxes—in real terms very little has been achieved in the form of additional revenue. Moreover, there is growing resentment amongst those who currently pay taxes, for they believe that the tax system is riddled with glaring inequities with a large and wealthy section of society remaining exempt. Add to that the fact that for each increase in the tax rate and in tax collection, the quantity and quality of public services—from law and order to education and health—has deteriorated sharply. With additional taxes worth 25–30 billion expected in the next budget, with agricultural incomes still exempt, each taxpayer does indeed have the right to complain and question the government's logic of trying to raise more revenue to cut the budget deficit so that it could get yet another IMF loan.

One obvious way to raise additional revenue, and thereby cut the deficit, would be to tax agricultural income. But for purely political reasons, the present government is loath to tax its ally, the wealthy agricultural lobby. And herein lies the dilemma. The agriculturists cannot be taxed, but to remain in the good books of the IMF the budget deficit has to be cut. The government's solution: additional taxes on those who have no option but to pay, and fewer government schools and hospitals. In essence then, what the IMF loans do is that they allow the wealthy—whether rural or urban—to continue with their lifestyles without having to pay the consequences of living well beyond their private as well as collective means. As such, the continued access to and availability of IMF and World Bank loans has become an excuse to postpone structural reforms, such as land reforms and levying agricultural income tax.

By propping up regimes which do not have the ability or inclination to take sensitive or tough decisions, organizations such as the World Bank and the IMF ensure their longevity. By lowering the budget deficit to 4 per cent of GDP, as per IMF instructions for the coming year, the present government in Islamabad can be assured of another large IMF loan, and at the same time will ensure its survival by not disturbing the powerful agricultural lobby. For this government at least, 4 per cent is indeed sacrosanct.

Source: This is an edited version of Zaidi, S. Akbar's, 'Is Four Per Cent Sacrosanct?', *The Herald*, June 1996.

reached alarming proportions. The downward rigidity of budgetary expenditures and lack of buoyancy in revenues have generated persistently large fiscal deficits over the last two decades. This has resulted in the accumulation of public debt at a fast rate. . . . There are no quick fix remedies to the debt problem. Pakistan will have to live with macroeconomic consequences of a heavy debt burden for several years'.[47] The Report argued that Pakistan's twin debt burden—domestic as well as external—is 'well beyond sustainable limits'. The reasons for this high debt were summarized as follows:

> (a) large and persistent fiscal and current account balance of deficits; (b) imprudent use of borrowed resources, such as wasteful government spending, resort to borrowing for non-development expenditures, undertaking of low economic priority development projects, and poor implementation of foreign-aided projects; (c) weakening debt carrying capacity in terms of stagnant or declining real government revenues and exports, and (d) rising real cost of government borrowing, both domestic and foreign.[48]

In the understanding of the DRMS, the debt crisis was 'essentially triggered by the un-sustainability of the level of current account balance of payments deficits and the pattern of their financing in the 1990s'.[49] The Report argued that it was this current account problem which caused both types of debts to accumulate, yet argued correctly, that there is a need to examine the issue of both domestic and foreign debt separately, since they have a different nature and impact on the economy.

Table 11.7 gives key data for Pakistan's domestic and external debt between 1993–2003. Total debt rose to 100 per cent of GDP in 1998/9, although this had come down substantially in 2002/3 and has over the last few years, remained between 55–60 per cent of GDP. As we show in Chapter 18, both key foreign debt ratios—external debt servicing as a percentage of foreign exchange earnings and of export earnings—fell a great deal in around 2001/2 and were far better then than they had been for many years. Until the huge debt rescheduling of 2002, most indicators regarding debt as a percentage of total revenue, tax revenue, current expenditure, etc. were not particularly impressive, which just goes to reinforce the observation made in Chapter 18, that 9/11 proved to be a real life saver for Pakistan, although of course, in subsequent years, the War on Terror caused huge human and economic damage to Pakistan. The period prior to debt rescheduling, 2000/1 in particular, has exceptionally worrying statistics, with foreign debt more than 60 per cent of GDP—see Table 11.7.

The general belief is that Pakistan's debt problem emerged from the profligate 1980s, when General Zia ul-Haq's government was spending far more money than it was receiving. Pervez Hasan in *Pakistan's Economy at the Crossroads* was one of the first who drew attention to this fact. He argued that while there were very high growth rates in the

Table 11.7
Profile of Domestic and External Debt: 1993–2011 (in Billion of Rupees)

	1993/4	1994/5	1995/6	1996/7	1997/8	1998/9	1999/2000	2000/1	2001/2	2002/3	2010/11
TD (1+2+3)	1,451.0	1,583.0	1,860.0	2,169.0	2,671.0	3,077.0	3,336.0	3,884.0	3,783.0	3,821.0	12,530
1. DD	702.0	798.0	909.0	1,041.0	1,176.0	1,392.0	1,578.0	1,731.0	1,717.0	1,852.0	6012
	(48.4)	(50.4)	(48.9)	(48.0)	(44.0)	(45.5)	(47.3)	(44.6)	(45.4)	(48.5)	(48)
2. ED	749.0	785.0	951.0	1,127.0	1,483.0	1,614.0	1,682.0	2,059.0	2,005.0	1,927.0	5707
	(51.6)	(49.6)	(51.1)	(52.0)	(55.5)	(52.8)	(50.4)	(53.0)	(53.0)	(50.4)	(46)
3. EL					12.6	70.1	75.4	94.0	59.5	41.6	811
					(0.5)	(2.3)	(2.3)	(2.4)	(1.6)	(1.1)	(6)
Total public debt servicing	134.4	154.4	201.8	258.7	278.3	343.1	366.3	340.3	431.2	304.7	436.4

Figures in parentheses are shares in total debt.

Ratio of external debt servicing to:

EE	55.4	35.3	36.5	38.0	44.8	28.8
FEE	34.9	23.6	23.4	23.7	26.5	16.0

EE: Export Earnings; and FEE: Foreign Exchange Earnings.

Ratio of total public debt servicing to:

Tax Revenue					78.4	87.8	90.3	77.1	90.2	54.8
Total Revenue	49.6	48.6	54.8	67.3	64.8	73.2	71.5	61.5	69.1	42.3
Total Expenditure	36.8	36.1	39.0	47.8	43.9	53.0	51.7	47.4	52.2	33.9
Current Expenditure	45.8	44.6	47.6	56.8	52.5	62.7	58.5	52.7	61.6	39.0

As % GDP

TD	92.2	84.1	85.9	90.2	99.8	104.7	106.0	113.5	104.3	95.1
DD	44.6	42.4	42.0	43.3	43.9	47.4	50.2	50.6	47.3	46.1
ED	47.6	41.7	43.9	46.9	55.4	54.9	53.5	60.2	55.3	48.0
EL					0.5	2.4	2.4	2.7	1.6	1.0

TD: Total debt; DD: Domestic Debt; ED: External Debt; EL: Explicit Liabilities;

Note: In 1997/8 the State Bank of Pakistan changed its classification of external debt and included Explicit Liabilities which were not accounted for earlier—see chapter 16 for further details. This means that the data for 1993–97 is not strictly comparable to that of more recent years since there were definitional changes—which were justified improvements—which make comparison difficulty. Nevertheless, one can draw a great deal of inference from the data.
Source: State Bank of Pakistan, *Annual Reports* (Karachi: various issues).

1980s, debt was being created which was being transferred to future generations who would eventually have to pay the high costs incurred during the 1980s.[50] The nominal public debt grew from around Rs. 155 billion to Rs. 802 billion in 1990 and further to 3,200 billion by 2000. The total debt burden was a mere 66 per cent in 1980 and rose to over 100 per cent by 1999. In 1980, the outstanding stock of public debt rose from 400 per cent of revenues to over 610 per cent by the end of 1999. Pakistan's public debt to revenue ratio in 2000 which was around 610 per cent was almost double India's (385 per cent), three times Mexico's (220 per cent), and ten times Chile's (60 per cent).[51]

Perhaps what is a surprising result is that it was the 1996–99 period in which the public debt burden rose very sharply, from 515 per cent of government revenues to 625 per cent, 'which was a more rapid increase than in the entire decade of the 1980s'.[52] The reasons for this are discussed below. Table 11.8 shows the real costs of borrowing and the real interest rates which were being used to repay the debt. In the 1980s, while the deficit was high and so was the accumulated debt, the economy was at least buoyant and growth was also very impressive; revenues were rising, development spending was high, and the economy was growing. The reasons why the debt burden increased so sharply in 1996–99 and the debt crisis came to the fore, was because growth rates had fallen in the 1990s and so had revenue. In the 1980s, there was real revenue growth of 8.2 per cent per annum while it was 3.9 per cent in the 1996–99 period, implying that not only was debt increasing, but it was becoming even more difficult to service the debt.[53] However, added to all this, the real crunch came when interest rates jumped from negligible levels in the 1980s and from a negative real interest rate in the early 1990s, to substantially high real interest rates in the 1996–99 period. One of the major criticisms that has been made against the way the Structural Adjustment Programmes in Pakistan had been imposed, had been around the 'liberalization' of interest rates. With a huge debt overhang and with high amounts of debt servicing at a time when the economy was doing noticeably poorly in the mid-1990s, and when governments were being changed frequently, interest rates were allowed to reach their 'correct'/market prices/levels. The result was that the Moeen Qureshi government, one of Pakistan's many caretaker governments, allowed interest rates to rise to the ridiculous level of over 20 per cent per annum, despite the fact that there was debt to be paid and the economy was in a poor situation. The consequences should not have been surprising to anyone. Clearly, the market had failed and in fact wrought havoc on an otherwise fledgling economy—see Box 11.6 for a hard hitting critique of the liberalization of interest rates, and see Box 11.7 in which Mahnaz Fatima and Qazi Masood Ahmed provide a useful analysis and summary of revenue and tax issues in the 1990s.

While there were numerous repercussions to the domestic debt crisis throughout the 1990s, the government sponsored DRMS, surprisingly, rather candidly, adds that as a consequence of the aggravating debt situation and declining revenues 'there has been a serious upsetting of the balance between defence and development since the early 1980s. The share of development in total government spending, which was 40 per cent in 1980 and 25 per cent in 1990, declined to 13 per cent in 2000. *Almost all the increase in share of interest payments has come at the cost of development*. While defence spending in constant prices more than doubled between 1980–81 and 1999–2000, real development expenditure actually declined over that period'.[54] Defence expenditure is now 50 per cent greater than development expenditure, while two decades ago, development spending was two-thirds higher than defence.

The DRMS argued that 'large as the public debt in Pakistan is, the debt crisis was essentially triggered by the unsustainability of the level of the current account balance of payments deficits and the pattern of their financing'.[55] The

Table 11.8
Costs of Borrowing and Interest Rates (Domestic Debt)

	1980s	1990–96	1996–99	1998/9	1999/2000
Primary Fiscal Deficit as % of GDP	4.7	2.0	–0.3		
Real Cost of Borrowing % per annum	2.5	–0.5	5.2		
Real growth of debt % per annum	9.9	5.7	5.8		
Real growth in revenues % per annum	8.2	3.9	–0.7		
Real growth of debt burden % per annum	1.6	1.8	6.5		
Stock of DD Rs. bn	353	846	1,125	1,288	1,481
Interest Payments Rs. bn	36	104	175	175	198
Nominal interest rate %	7.7	10.9	13.9	13.6	13.4
Price change %	7.2	11.2	9.0	5.9	3.5
Real interest rate %	0.5	–0.3	4.9	7.7	9.9

Source: Government of Pakistan, *A Debt Reduction and Management Strategy*, Debt Reduction and Management Committee (Islamabad: 2001).

Box 11.6

Real Cost of Public Borrowing: Determinants and Trends

The real cost of domestic borrowing is the nominal interest rate minus the rate of inflation. As the table below indicates, the real costs of Pakistan's domestic debt have varied greatly over time. During the 1980s the average nominal cost of 7.7 per cent per annum was largely offset by an inflation rate of 7.2 per cent per annum. The real cost of domestic public debt was thus only 0.5 per cent per annum. At first sight, this may appear surprising because the government started paying very high nominal interest rates on National Saving Schemes (NSS) in the early 1980s while inflation was still relatively low. Two factors dampened the impact of high rates of return on NSS instruments on government interest payments. First, the initial weight of unfunded debt (borrowing through NSS) was small. Second, the reported interest payments on NSS were low because the bulk of this borrowing is in the form of zero coupon five or 10-year certificates, the interest on which is recorded only where the term certificates are encashed. There is thus a considerable lag in interest payments. But the principal reason why government nominal and real interest rates were low in the 1980s was that the bulk of government borrowing was at less than market rates as all interest rates were administratively determined and government debt was sold in segmented markets. The large reserve requirements for commercial banks (5 per cent cash reserve requirement and 30 per cent liquid asset requirement) forced them to buy low-interest Treasury paper.

Real Cost of Public Debt

(% Per annum)

	Real Cost of External Debt	Real Cost of Domestic Debt	Total Cost of Public Debt
1980s	3.4	0.5	2.5
1990–96	–0.9	–0.3	–0.5
1996–99	5.4	4.9	5.2
2000–4 (Projected)	4.4	4.4	4.4
2004–10 (Projected)	1.8	3.4	2.5

Financial sector liberalization, initiated in 1989 with the assistance of the World Bank, led to a full market-based auction programme for government borrowing. However, this liberalization was premature and ill timed because it assumed a quick reduction in fiscal deficit to sustainable levels (Hasan, 1998). Its impact, on the contrary, was to sharply raise the Government interest bill. Between 1987–88 and 1993–94 interest payments on domestic debt increased nearly trebled and the average nominal interest rate rose by 84 per cent to 11.5 per cent. Paradoxically, the much higher interest payments made the fiscal deficit reduction difficult and the Government resorted during 1990–1993 to very large borrowing from the banking system to finance the burgeoning deficit. The sharp acceleration in inflation during 1990–1996 ultimately wiped out the effect of higher nominal interest rates, so that average real interest rate on government domestic debt was slightly negative during 1990–1996.

For the most part of the last two decades, the real cost of government domestic borrowing has been negligible and, therefore, the growth in burden of public debt was moderated. The situation now is sharply different. The real cost of domestic borrowing jumped up to the average of 9 per cent per annum over 1998–2000, as the inflation rate dropped and nominal interest rates stayed high. Even with the sharp reductions in the rates of return on the NSS since May 1999, the average interest rate paid on these schemes will remain high for some years because of the very substantial time lags mentioned above. The Debt Committee is assuming that the real cost of government domestic borrowing can be brought down to 3–4 per cent in the coming years mainly through a sharp reduction on rates offered for fresh borrowing.

The issue of interest payments on foreign debt has not received much attention, at least in relation to public debt. Nominal interest payments on foreign debt at Rs. 47 billion in 1999–00 were only a fraction of the interest payments on domestic debt of Rs. 198 billion. As a percentage of GDP, interest payments on foreign debt have rarely exceeded 1.5 per cent. The average annual nominal interest rate on external debt until recently did not exceed 4 per cent because in general Pakistan avoided high cost commercial borrowing till the mid-1990s. But just as in domestic debt, the relevant rate for external debt is the real rate of interest after allowing for international inflation. International inflation, already low in the 1980s, came down to zero during 1995–1999, implying a steady rise in the real interest rate on Pakistan's foreign debt in dollars. Furthermore, there has been real devaluation of the Rupee, which increases the real interest rate by increasing the real burden of external debt. There has been, in fact, substantial real depreciation of the rupee during the 1980s, relatively little change during 1990–1996 and significant real devaluation since then.

In estimating the real cost of foreign public debt, the Committee has added the capital loss on foreign exchange to the nominal interest payment on external debt and then adjusted this nominal cost for the rate of domestic inflation. The calculations suggest that real cost of external debt averaged 3.4 per cent per annum during the 1980s. It has risen significantly since then, reflecting both low international inflation and the accelerated pace of real depreciation of the Rupee during the last few years. For the period 1996–1999, the real cost of external borrowing is estimated at 5.4 per cent per annum, even higher than the high cost of domestic debt. In projecting future costs of external debt, it is necessary to take into account the expected changes in the nominal value of Pakistan's currency, which captures both the differential between international and domestic inflation and real depreciation, if any.

Source: Government of Pakistan, *A Debt Reduction and Management Strategy,* Debt Reduction and Management Committee (Islamabad: 2001), 18–19.

Box 11.7

Fiscal Issues in the 1990s

The overall policy thrust during the decade of the 1990s was, therefore, to increase the overall tax-to-GDP ratio by focusing on generating a greater share of direct taxes. There was commensurate emphasis on liberalization. The assumption was that decrease in custom duties would discourage smuggling and would thereby enable higher domestic production that would, in turn, contribute to higher tax generation overall. This assumption did not bear out as it appeared that smuggling in Pakistan became more an administrative issue than an economic issue. By and large, domestic industry was still ill-equipped to compete with imported finished goods. Import duty reduction would, therefore, have an adverse impact on domestic production capability, thereby adversely affecting tax revenue generation. The upshot, therefore, was a lower share of custom duties which would be offset through a higher share of sales tax and periodically through petroleum surcharge.

The decade of the 1990s can, therefore, be seen as the one throughout which there was a great emphasis on increase in direct taxes, reduction in import duties, and compensation of the loss in revenue due to the latter through increase in sales tax. The combined effect of the above moves, however, did not make a dent in the overall tax-to-GDP ratio which not only fluctuated between 10.48 per cent and 12.26 per cent but actually fell from 11.82 per cent in FY1991 to 11.71 per cent in FY2001. Clearly, there were gaps not just in implementation but also in the taxation policy that was adopted under the influence of the IMF that emphasized rapid reduction in import duties which had been a major source of revenues in a country ill-equipped to increase direct tax collection efficiently and equitably. The effort during the decade of the 1990s can be characterized as one that aimed more at offsetting the loss from import duties' reduction rather than attempting to increase tax revenue generation as such. As is evident from Table 4, while the share of direct taxes increased from 16.6 per cent in FY1991 to 32.9 per cent in FY2001 and that of sales tax increased from 16.6 per cent in FY1991 to 38.3 per cent in FY2001, the share of import duties in total taxes fell from 40.8 per cent in FY1991 to 15.9 per cent in FY2001. The upshot was a bare minimum ability to maintain the overall tax-to-GDP ratio which may be viewed as an achievement given the reduction in import duties. Or, it may be viewed as a failure given the inability to increase direct taxes and/or sales taxes in proportions greater than the decrease in import duties.

The analysis demonstrates that the efforts to increase the overall tax-to-GDP ratio did not prove to be successful. However, the contribution of various types of taxes to total tax collection did change. While the share of direct taxes and sales tax increased, that of import duties fell significantly. Import duties underwent drastic reduction mainly under IMF's pressure to liberalize trade more than that required even under the WTO agreements. While this measure definitely affected domestic industrial production adversely as most domestic producers are still ill-prepared to compete with imported finished goods, domestic production effort also experienced the negative impact of increase in direct and sales taxes. As the IMF prescribed tax effort was deflationary, significant increases in output could not be recorded that could have fed back favourably into tax generation and budget deficit reduction.

The upshot was that a relationship between the tax-to-GDP ratio and the budget deficit-to-GDP ratio could not be ascertained. Despite this, the governments mostly remained determined to follow the IMF prescriptions about tax reforms too. The second Benazir government that resisted the IMF in import duty reduction soon found itself out of the office. Pakistan's taxation reform was, therefore, driven not just by domestic politico-economic considerations but also by those of the countries which are the major financiers of the IMF. These countries would like to have our economic frontiers thrown open so that their manufactured products and services find easy passage into the markets of developing countries.

As the overall tax-to-GDP ratio could not be increased appreciably, budget deficits had to be kept contained by decreasing the development expenditure. This was required all the more also because of increasing pressure on debt-servicing. As percentage share of internal resources in total resources declined due to the reasons discussed herein, the share of external resources increased. Pakistan's reliance on external financing increased due to a tax reform effort that remained unsuccessful not only intrinsically as it failed to generate more resources internally but also because it affected the production potential of the country adversely. This latter effect fed back into the issue of budget deficits and rising external dependence. More requirement of external financing means more of the financiers' conditionalities. That is, the above cycle stands reinforced when the need is to break away from it. While the fiscal reform exercise has been self-defeating, we pursue more of it as it suits both domestic and international politico-economic agendas.

Source: Fatima, Mahnaz and Qazi Masood Ahmed, 'Political Economy of Fiscal Reforms, *The Pakistan Development Review*, PIDE, vol. 40, 2001.

current account balance during the 1990s was on average 4.8 per cent of GDP, increasing further to 6 per cent if one (correctly) includes the Foreign Currency Accounts. Exports and remittances had both fallen to below par levels in this period and there was a decline in foreign exchange earnings from 1996 to 1999. Added to all this, as we show in the chapters on structural adjustment—Chapters 16 and 17—there was constant devaluation of the rupee which made it more expensive to service foreign debt in rupee terms, something that has continued to happen in 2011 and 2012. With the economy doing poorly, revenues not rising and an overall investment and confidence crisis in the country, it is not surprising that foreign debt and debt servicing kept increasing. As Box 11.8 shows, Pakistan paid back in terms of interest alone, much more than it actually borrowed, a strange arrangement if ever there was one.

Box 11.8

What Have Our Loans Cost Us?

Much has been written about our external debt, and rightly so. The fact that Pakistan's external debt is almost 54 per cent of our GDP is indeed worrying. Add to that the fact that the country's domestic debt is only slightly lower, and we have a major crisis on our hands. In this brief article, I propose to look at a critical dimension which relates to Pakistan's external debt and its repayment, which has been overlooked by most analysts.

The table below reveals a number of extraordinary facts related to the growth in external debt over the last decade. Perhaps the most astonishing revelation is that net addition to Total Debt Outstanding in the period 1990–2000 was $15.451 billion while in the *same period the total amount repaid as Interest and Principal was $36.611 billion*. Pakistan has been making average repayments to its loans enacted over many decades of the order of $3.66 billion annually over the last decade alone, and yet, has seen its external liabilities almost double. Much of these repayments have been based upon increased borrowing, suggesting that a substantial proportion of new loans enacted each year do not come into the country and are used simply to pay-off old debts. This is an important point to consider as this point is usually overlooked whenever a new loan is granted to Pakistan. The euphoria which follows such agreements ignores the reality that only a small amount of the new loan is actually available to be made use of in the country.

Another revealing feature of the table is the increase in the proportion of short and medium term debt over the last decade, which is probably responsible for the large annual repayments made each year as shown in column VI. In 1990–91, short and medium term loans were a mere 10 per cent of outstanding external debt to official creditors; this amount more than doubled in 1998–99 when it was 22.2 per cent, and since 1995–96 has been almost a fifth of the total debt. In contrast, long term debt has increased by only 5.7 per cent since 1994–95, while short and medium term debts have increased by 28 per cent over the same period.

There are two aspects to rely increasingly on short term and medium term debts. Firstly, by definition, they have to be repaid (or rolled over) far sooner than the longer term debt which could have a tenor of even a decade, compared to the one-to-three year shorter term debt. Secondly, because of its nature, this debt is far costlier than longer term debt. The IMF's three-year Enhanced Structural Adjustment Facility for example, which constitutes long term debt, carries an interest rate of only 0.5 per cent and has a five-and-a-half year grace period and a 10-year maturity period. In contrast, even IMF short-term loans (such as Stand-by Arrangements), which are far less costly than commercial loans, carry an interest rate which is a weighted average of rates on short-term paper of the five currencies which constitute the IMF currency, the SDR (Special Drawing Rights). The Annual Report 1999–2000 of the State Bank of Pakistan concedes the fact that due to the nature of the small and medium term debts, payments of principal (column IV) dominate those made as interest (column V).

Yet another important finding from the table is that in the last two fiscal years, the total debt servicing has fallen substantially. This has happened only because of the rescheduling that had taken place two years ago. The importance of this rescheduling can be gauged from the fact that in the last financial year 1999–2000, the total debt to be repaid had there been no such arrangement, was of the order of $7.827 billion

External Debt $ billion

Year	Total Debt Outstanding			Annual Debt Servicing		
	I	II	III	IV	V	VI
	Long Term	Short/Med Term	Total	Principal	Interest	Total
1990–91	15.471	1.824	17.295	1.669	0.711	2.381
1991–92	17.361	2.268	19.629	2.086	0.767	2.853
1992–93	19.044	3.002	22.046	2.130	0.814	2.944
1993–94	20.322	4.160	24.483	2.722	0.890	3.612
1994–95	22.117	4.409	26.526	3.304	1.020	4.324
1995–96	22.275	5.460	27.735	3.262	1.085	4.347
1996–97	23.145	5.140	28.285	4.038	1.042	5.080
1997–98	23.042	5.940	28.982	3.575	1.095	4.670
1998–99	23.101	6.572	29.673	1.905	0.752	2.657
1999–2000	23.834	5.622	32.746*	2.366	1.377	3.743

* Includes the 'New Category' of debt worth $3.29, introduced by the State Bank of Pakistan this year, which has not been included in previous formats.

Source: State Bank of Pakistan, *Annual Report* (Karachi: various years).

the highest ever. However, $4.084 billion was rescheduled and Pakistan had to repay only (!) $3.743 billion. It is difficult to imagine where Pakistan would have come up with the additional money had the rescheduling not taken place. The fact that the economy saw some signs of improvement and 'stability' reflected in a small improvement in the growth rate, were critically dependent on this rescheduling.

Probably the most important conclusion to draw from the table and arguments presented here is that Pakistan is caught in a deep debt (death?) trap from which there seems to be no way out. Those institutions and countries which have lent us money over the last few decades, have reaped great rewards from their investments. They are like the money lender or landlord, and Pakistan the indebted peasant, where just to survive and pay off some of our earlier debts, we are having to borrow, increasing further our debt liabilities in the process. Just as generations of peasants have been enslaved by their debts, so has Pakistan. Like peasants, we too have paid out huge sums of money in the form of interest and principal but despite this, rather than diminishing, our debt liability has increased markedly.

Over the last two decades whenever I have spoken about the international financial institutions and donors, and have shown how loans and debts have had a negative impact on Pakistan's economy bringing it on the verge of bankruptcy and default on so many occasions, I have always been asked: then why do these institutions and countries make loans to a country like Pakistan? The answer from this table should be quite obvious. Even near-bankrupt and close-to-default countries like Pakistan, are profitable investments for the loaners. Not only do they get far more than what they loaned, the debt liability increases and countries like Pakistan are caught in a perpetual debt trap having to make repayments for years to come. A very profitable business indeed!

Source: Zaidi, S. Akbar, 'What are we paying for our Loans?', *Pakistan Journal of Applied Economics*, vol. 15, nos. 1 & 2, 1999, (published in 2001).

It was the 1996–99 period again, in which there was further deterioration in the external debt situation, while all the relevant variables were deteriorating—see Table 11.9. Based on Table 11.9 the DRMS report argued that during the 1996–99 period, 'the real interest rate on external debt rose while real growth in foreign exchange earnings turned negative. . . . Given the enormous current account balance of payments deficits and the very fragile pattern of their financing through RFCDs [Resident Foreign Currency Deposits], there was a certain inevitability about Pakistan's foreign exchange crisis. The imposition of economic sanctions in June 1998 merely accelerated its arrival'.[56]

Sakib Sherani identified a number of 'principal factors' that had been responsible for Pakistan's high and increasing debt.[57] This list included deep seated structural factors and shorter term causes. These include a low savings rate far below comparable countries, and to make matters worse, national savings have been declining; there has been a lack of fiscal discipline, with tax revenue having declined as a per cent of GDP in the 1990s and in the 2000s as well, which indicates 'lower nominal growth in tax collection as compared to the increase in GDP'—political interference and weak institutions have been held responsible for this, as well as schemes such as the Motorway and the Yellow Cab Scheme; the public sector has borne large losses which the public sector in general has had to bale out; there was a decline in long term capital inflows over the 1990s, which 'compelled authorities to place greater reliance on expensive commercial borrowing'; agreeing with the DRMS based on the work of the IMF, the 'most important causative factor' behind the increase in external debt 'was the persistence of large non-interest current account deficits'; as we argue above as well, the sequencing of reforms has also been a problem with substantially higher market interest rates as a consequence of liberalization; the structural adjustment reforms also put a lower ceiling on bank borrowing for budgetary support, which forced government to shift to non-bank borrowing; and, there was capital flight as well, which caused the vulnerability of the external account—also see Table 11.10 for some international comparisons.

What is interesting and worth emphasizing, however, is the impact of Pakistan receiving considerable foreign 'aid'—a

Table 11.9
Dynamics of the External Debt Burden

	Non-interest CAD	Real cost of borrowing	Real growth of external debt	Real growth in FEE	Growth in external debt burden
1980s	–2.9	2.0	6.4	4.7	1.7
1990–96	–2.5	2.8	6.9	5.4	1.5
1996–99	–1.3	4.0	7.6	0.1	7.5

Source: Government of Pakistan, *A Debt Reduction and Management Strategy*, Debt Reduction and Management Committee (Islamabad: 2001), 25.

Table 11.10 A Cross-Country Comparison of External Debt Indicators

	1990	2000
Total External Debt (% of Gross National Income)	**1990**	**2000**
Pakistan	52.9	53.8
All developing countries	34.1	39.1
Low-income developing countries	49.2	53.4
Middle-income developing countries	30.3	36.3
Heavily-indebted countries	88.1	100.3
South Asia	32.4	27.2
Total External Debt Service (% of Gross National Income)	**1990**	**2000**
Pakistan	4.9	4.8
All developing countries	3.8	6.3
Low-income developing countries	3.8	4.6
Middle-income developing countries	3.8	6.6
Heavily-indebted countries	7.0	8.1
South Asia	2.9	2.4
Total External Debt (% of Current Foreign Exchange Receipts)	**1990**	**2000**
Pakistan	250.0	300.6
All developing countries	161.0	113.3
Low-income developing countries	298.8	181.5
Middle-income developing countries	135.6	102.4
Heavily-indebted countries	331.0	237.9
South Asia	324.7	141.5
Total External Debt Service (% of Current Foreign Exchange Receipts)	**1990**	**2000**
Pakistan	23.0	26.8
All developing countries	18.1	18.1
Low-income developing countries	23.0	15.8
Middle-income developing countries	17.2	18.5
Heavily-indebted countries	26.2	19.3
South Asia	28.7	13.8

Source: Sherani, Sakib, *Escaping the Debt Trap: An Assessment of Pakistan's External Debt Substantiality*, Asian Development Bank, Pakistan Resident Mission Working Paper Series No. 1 (Islamabad, December 2002), 32.

misnomer, no doubt, for these are loans—and accumulating exorbitant amounts of debt. One would have expected that such huge amounts of inflows—see Box 11.8 and Chapter 25 on war and aid—would have benefitted the country in terms of growth and poverty reduction. However, in the case of Pakistan, foreign capital inflows have been used entirely to finance consumption, but moreover, 'the increase in foreign capital has resulted in lowering the savings by the same magnitude, and as such foreign aid may have contributed *almost nothing to growth*'.[58] Moreover, while this 'aid' has not been put to proper use, A. R. Kemal concludes, not surprisingly, that 'debt accumulation in the case of Pakistan is resulting in low growth'.[57]

While there are a large number of factors that may have aggravated the debt problem, Sherani argued that 'initiated in 1989 as part of financial sector liberalization under the aegis of the IFIs [international financial institutions], nearly trebled the interest payments on domestic debt between FY 1989 and FY 1994. The average nominal effective interest rate rose from less than 6 per cent to 11.5 per cent. The other factor which became increasingly relevant, especially for the latter half of the 1990s, was the frequency and magnitude of currency devaluation that took place'.[60]

Looking at the situation soon after 9/11, say in 2004, it was difficult to appreciate the fact that clearly, Pakistan had a massive and acute debt crisis just a few years ago, for all of the 1990s. The reprieve that the economy had been given, came about on the basis of fortuitous extraneous factors, and not on the strategy proposed by the Debt Reduction and Management Committee or on other factors. As a consequence, there was debt rescheduling worth $12.5 billion, debt write-offs, and the creation of sufficient fiscal space which allowed the government to target some key areas of the economy, notably development and poverty issues. A lower interest rate also helped, as did an increase in exports and growing remittances which helped raise foreign exchange reserves to over $12 billion, and further still. Nevertheless, with the total debt almost 57 per cent of GDP, it will always have a bearing on some aspects of the economy, such as interest payments, and will need to be kept as low as is sustainable. That sustainability will arise through higher economic growth, better and larger investments, and far

greater tax generation. Moreover, the claim by some sections of Pakistan's civil society that Pakistan's loans should have been written off, is made absurd, when what is required is greater accountability—see Box 11.9.

11.4 Summary and Further Reading

11.4.1 Summary

This chapter makes the simple, though important, point that fiscal deficits and expenditure by government in excess of its revenue are not always and everywhere 'a bad thing'. What matters is the type of expenditure and the context of the fiscal deficit. We have looked at the conventional wisdom which states that numerous ills that afflict the economy are said to originate from high fiscal deficits. After looking at the more general arguments, in which we showed that it is not always such a good idea to reduce public spending or to have a fiscal surplus or balanced budget, we then examined the specific case of Pakistan.

In the case of Pakistan, it seems that conventional wisdom regarding the fiscal deficit has been turned on its head. The high fiscal deficit did not do all the things it was supposed to, and until more recently was rather 'benign', yet, at around between 4–6 per cent, the fiscal deficit in Pakistan is an important issue.

We have emphasized the point that, in itself, the fiscal deficit should not be of concern. What is critical is the use to which public money is being put (Box 11.5 and Appendix 11.2). If government spends more on the military and on interest payments, as opposed to the social sectors and development, causing the deficit to increase, that is a worrying sign. It is important to have some accountability about where the domestic and foreign debt has gone. Has it been used productively, or has it been squandered away? Hence, the question of public expenditure and fiscal deficits may be better answered by recourse to issues and ideas of governance, rather than according to the rather limited concerns of accountancy. Schemes like Nawaz Sharif's 'National Debt Retirement Programme' were meaningless given the huge size of the debt, and avoided issues of accountability—see Box 11.9. For this reason, we also suggest that debt retirement from privatization proceeds is improbable and would be a waste of money, which could be put to better use in social and infrastructure development (Appendix 11.3).

One problem that the debt raises is the high interest rate which government must pay on domestic debt, which was close to 20 per cent per annum in the mid 1990s, and rose again to 16 and 17 per cent in 2011 and 2012. The financial sector liberalization reforms under the Structural Adjustment Programme are partly responsible for these high interest rates, and are discussed along with the fiscal deficit issue in Part VI of this book.

As mentioned in Chapter 18, Pakistan, until 2002, had a massive debt problem, where debt was in excess of 100 per cent of the GDP. Debt servicing was eating away revenue received for development and other expenditure, and there was a serious debt crisis in Pakistan. Unlike most countries, Pakistan had both an external and domestic debt problem for most of the 1990s. We assess the causes for accumulated debt and found that reforms and structural adjustment had a crucial role to play in creating and aggravating this crisis.

After 2008 both, the deficit and debt, rose to extremely high levels and it is clear that here the IMF or World Bank were less to blame. The People's Party government's mismanagement, along with a number of negative global factors, aggravated the situation—also see Chapter 18.

11.4.2 Further Reading

There are no books which examine the issue of the fiscal deficit; some academic journal articles are all that are available. For the case of Pakistan, see: Zaidi, S. Akbar, 'The Structural Adjustment Programme and Pakistan: External Influence or Internal Acquiescence?', *Pakistan Journal of Applied Economics*, vol. 10, nos. 1 and 2, 1994; Zaidi, S. Akbar, 'Locating the Budget Deficit in Context: The Case of Pakistan', *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995; Haque, Nadeemul and Peter J. Montiel, 'Fiscal Policy Choices and Macroeconomic Performance in the Nineties', in Nasim, Anjum (ed.), *Financing Pakistan's Development in the 1990s* (Karachi: Oxford University Press, 1992); Haque, Nadeemul and Peter J. Montiel, 'The Macroeconomics of Public Sector Deficits: The Case of Pakistan', Working Paper no. 673,(Washington DC: World Bank, 1991); and Haque, Nadeemul and Peter J. Montiel, 'Fiscal Adjustment in Pakistan', *IMF Staff Papers*, vol. 40, no. 2, 1993. See also the references cited in note 23—in particular, the World Bank publications.

For a more general treatment of fiscal deficits, see: Buiter, Willem, *Principles of Budgetary and Financial Policy* (Brighton: Harvester, 1990); Blinder, A. S. and Robert Solow, *The Economics of Public Finance* (Washington DC: Brookings Institute, 1974); Arrow, Kenneth and M. J. Boskins, (eds.), *The Economics of Public Debt* (London: Macmillan, 1988); Easterly, W. and K. Schmidt-Hebbel, 'Fiscal Deficits and Macroeconomic Performance in Developing Countries', *World Bank Research Observer*, vol. 8, no. 2, 1993; Easterly, W. and K. Schmidt-Hebbel, 'The Macroeconomics of Public Sector Deficits: A Synthesis', Working Paper no. 775 (Washington DC: World Bank, 1992); and Eisner, Robert, 'Budget Deficits: Rhetoric and Reality', *Journal of Economic Perspectives*, vol. 3, no. 2, 1989.

The following reports and papers are also useful: Fatima, Mahnaz and Qazi Masood Ahmed, 'Political Economy of Fiscal Reforms in the 1990s', *The Pakistan Development Review*, vol. 40, no. 4, Part 2, 2001; A. R. Kemal, 'Debt Accumulation and its implications for Growth and Poverty', *The Pakistan Development Review*, vol. 40, no. 4, Part 1, 2001; Sakib Sherani, 'Escaping the Debt Trap: An Assessment of Pakistan's External Debt Sustainability', *Pakistan Resident Mission Working Paper No. 1* (Islamabad: Asian Development Bank, December 2002); and perhaps the most important, *A Debt Reduction and Management Strategy*, produced by the Debt Reduction and Management Committee of the Government of Pakistan, March 2001.

Box 11.9

Accountability, Not Write-off

Civil society's 'demand' for a write-off of Pakistan's foreign debt following the floods and the devastation they have caused, while well meaning, is a serious case of flawed politics. It is also, sadly, reflective of many aspects of civil society which many observers, even those sympathetic to civil society, have critiqued for some years now. Perhaps the most important observation following this so-called demand is, that civil society has now become completely depoliticised and members and organizations which constitute civil society, have now become part of the status quo of the state, rather than in contradiction to it, challenging that status quo. Had the finance minister or the prime minister made such a demand, one would have understood, but civil society has only exposed its own lack of political understanding.

Clearly, Pakistan's debt of $55 billion is a huge burden on the economy and on the common people. However, the problem is that the loans that 'Pakistan' has acquired over the last three decades when the debt problem got out of hand, have all been taken by Pakistan's governments, both military and those composed of Pakistan's civil and political elites. The 'common man' (seldom the common woman) on whose names these loans have ostensibly been taken, has never been consulted, although she has had to bear the burden of these loans and the debt they have created. While Pakistan's elites who are represented in government take these loans, usually so that they do not have to impose taxes on themselves, it is left to the common man and common woman to pay back these loans, through higher indirect taxes, reduced subsidies, and increased surcharges.

On the one hand then, it makes sense to make the demand that this unfair burden be lifted from Pakistan's poor common men and women, and this is why the government of the day can make such requests to donors. However, the bigger problem is a political economy one: the question needs to be asked as to what has happened to the loans taken by this and previous governments. While loans of many billions of dollars have been taken in the past and continue to be taken, there is little to show in terms of development output which would have suggested that the money has been fairly and honestly utilized. All evidence points to the fact, that there has been much embezzlement and misappropriation of the money received in the name of Pakistan's common people, and there are allegations that even humanitarian aid money which came in after the 2005 earthquake, was pocketed by some of those in power. If this is indeed the case, civil society needs to ask questions about the use of that aid and those loans. If it can prove—which would not be very difficult—that much has been stolen, it needs to hold the leaders and governments who took the loans, to be made accountable to the people of Pakistan on whose name they keep going back for even more loans.

It is accountability that civil society should be demanding, not debt write-offs. Civil society needs to make an assessment of the amount of aid taken in the past, its use, how much was spent, and how much seems to have gone missing. It then needs to hold all governments accountable about the loans taken in the people's name. Moreover, it also needs to hold donors accountable to explain why they continue to fund dead projects and why they pump in huge amounts of money which is badly spent and often not accounted for. However, these are political questions, not those one expects an answer from a civil society which has also now become increasingly donor-dependent.

One finds it odd that civil society has asked donors to write-off debts, while its own donor-dependence has only increased in recent years. Just as the country has asked for increased donor assistance, so has civil society. Where else would human rights, or women's, or minority groups be, if there was no donor funding. There are few civil society initiatives in Pakistan which would survive without donor funding. In fact, many donors set the development and human rights agenda in Pakistan, and Pakistan's civil society and NGOs merely work on projects till the funding runs out. And often while civil society has held its elected representatives accountable—such as during the continuing fake degree scandal—and held government responsible for not fulfilling its promises, it has seldom volunteered to hold itself accountable for what it does or does not do, or how it uses donor funds.

Perhaps it is this reason why civil society organizations have launched a campaign for an 'unconditional' write-off of Pakistan's external debt, rather than for a campaign to hold donors and government accountable for the loans being taken in the people's name. For the most part, Pakistan's NGOs have increasingly become contractors doing the government's bidding, and civil society's voice would hardly be heard if it was not for donor funding. A depoliticised, donor-dependent civil society is the last forum where one would expect to hear political demands. Pakistan's civil society needs to realise that in order for it to emerge as an independent entity, not as an appendage or mouthpiece for government, it needs to think and act politically.

Source: Zaidi, S Akbar 'A Senseless Demand', *Dawn*, Karachi, 3 September 2010.

Appendix 11.1

The Budgetary Deficit and the Economy

Aftab Ahmad Khan presents his considered opinion on the budget deficit and argues, like many others, that the large budgetary deficit is the most serious issue confronting the economy.

It is a well known fact that Pakistan has experienced large fiscal deficits over the last two decades and currently budgetary imbalance is the most serious macro problem confronting the economy, requiring bold structural policy actions with long lasting effects on financial stability. Repeated attempts by the government, including the implementation of structural adjustment programmes with assistance from the International Monetary Fund (IMF), have only achieved partial success. The consolidated fiscal deficit during the period 1980/81–1991/92 averaged around 7.2 per cent of Gross Domestic Product (GDP) annually. In 1992/93 this deficit was Rs. 107.7 billion or 8 per cent of the GDP. In 1993/94 it was brought down to Rs. 907 billion or 5.8 per cent of the GDP. In the current fiscal year (1994/95) while the budget estimated it at Rs. 71.9 billion (4 per cent of the projected GDP), the current indications are that it would be around Rs. 105 billion or 5.7 per cent of the revised projected GDP of Rs. 1846 billion.

It is crystal clear that Pakistan has to reduce the dimensions of the overall fiscal deficit; otherwise there would be further deterioration of the already weak budgetary position with profound de-stabilizing consequences for the economy. It would intensify pressures on the already strained balance of payments with consequent financial instability, thus undermining Pakistan's international credit worthiness, crowd out private investment by pushing real interest rates upward and/or fuel inflationary expectations as increasing monetization of the deficit becomes unavoidable. With large and growing deficits the economy could easily enter into a trap where an upward spiralling cycle of inflation–devaluation–rising interest rates–rising wages and salaries–rising inflation could disrupt production and investment activity and could lead to large scale capital flight.

The deficit has remained high because of the political and administrative inability of the Government of Pakistan to mobilize adequate resources or to restrain expenditures. The present tax structure of Pakistan falls short in all major functions of a modern tax system: revenue generation, efficient resource allocation, and equity. The system is characterized by the dominance of indirect taxes (nearly 78 per cent of total tax proceeds).

At the same time the system has many exemptions and concessions. Several income categories including agricultural are excluded from income taxation and those subject to taxation, with the exception of wage and salary earners, are known to pay only a fraction of their share. Despite considerable wealth concentration and sharp increases in asset values, especially real estate, Government revenue from taxation of wealth and capital gains is small. Tax administration is weak, resulting in a high level of tax evasion, corruption and harassment of taxpayers. In order to maintain the present low tax/GDP ratio (13.3 per cent in 1993/94), the tax system needs to be supplemented with frequent ad-hoc measures. In other words it is inelastic. Perhaps more importantly the tax system has haphazard effect on resource allocations as a large number of concessions result in widely different effective rates within the same industry. Moreover tax evasion has encouraged the growth of the 'black' or 'parallel' economy, which in turn results in cumulative revenue loss to the public exchequer.

On the expenditure front, defence spending accounts for 23.4 per cent of consolidated government expenditures and interest payments constitute 24.5 per cent. The share of general administration in total governmental expenditures is 6.7 per cent while social, economic and community services account for 15.4 per cent. With this pattern of current expenditures, it has not been possible to impose large cuts. The burden of expenditure reduction, accordingly, has fallen and continues to fall on development expenditure at the cost of renovating and expanding the much needed infrastructure facilities.

Pakistan, like most developing countries, makes use of three methods to finance the budget deficit: domestic borrowing from non-bank sources, external borrowing, and borrowing from the banking system. The magnitude of the deficit and the sources and amounts of financing since 1981/82 are depicted in [Table 1].

Each method of covering the deficit carries different costs and benefits for the economy. Besides the direct budgetary cost, domestic borrowing from non-bank sources can lead to crowding out of investment by raising the interest rates or as a result of non-price credit rationing. However, it has the benefit of avoiding or postponing the inflationary impact of the given deficit.

External financing helps to preserve domestic investment rates, but at the cost of crowding out future domestic consumption/investment when the foreign debt must be serviced or repaid through higher exports and lower imports.

Bank borrowing for budgetary support can be either from commercial banks or the central bank. When a commercial bank subscribes to a government loan, its cash (including deposits with the State Bank of Pakistan) is reduced. This act by itself involves a withdrawal of private purchasing power at the same time as there is an addition to public purchasing power. The expenditure of Government thus financed is, therefore, non-inflationary. But the crucial point is, how did the bank acquire the cash to subscribe to the government loan and how are the bank's future operations affected as a result of the subscription to the government loan? Assuming that the bank had no surplus cash when it made the investment in government securities, the cash needed for the loan subscription could be acquired out of the proceeds of maturing loans or maturing investments in government securities. In such a case, the new asset replaces the old asset, and the bank does not add to the aggregate volume of its assets (and liabilities). If this description were to apply to the banking system as a whole, the process of financing a

Table 1: Sources and amounts of financing the consolidated budget deficit of federal and provincial governments, 1980–1995 (Rs. bn)

	Consolidated budget deficit	Deficit as % of GDP	Banking system		Non-banking		External (net)	
			Amount	%	Amount	%	Amount	%
1980/1	14.6	5.3	2.4	16.1	4.5	30.9	7.7	52.9
1981/2	17.2	5.3	5.5	32.1	6.3	36.8	5.3	31.1
1982/3	25.7	7.1	6.1	23.9	14.4	56.0	5.2	20.1
1983/4	25.1	6.3	7.9	31.3	12.3	48.8	5.0	19.9
1984/5	36.8	7.7	18.7	50.9	12.9	35.0	5.2	14.1
1985/6	41.6	8.1	6.1	14.6	27.0	64.7	8.6	20.6
1986/7	16.7	8.2	10.9	23.4	27.4	58.6	8.4	18.0
1987/8	57.6	8.5	13.9	24.2	30.9	53.7	12.7	22.0
1988/9	56.9	7.4	0.8	1.4	37.9	66.6	18.2	32.0
1989/90	56.1	6.5	3.5	6.3	29.6	52.8	22.9	40.9
1990/1	89.2	8.7	43.4	48.6	23.7	26.6	22.1	24.8
1991/2	90.0	7.4	70.5	78.3	–3.1	–3.4	22.6	25.1
1992/3	107.7	8.0	62.6	58.1	19.7	18.3	25.4	23.6
1993/4 (PA)	90.7	5.8	12.9	14.2	55.0	60.0	22.8	25.1
1994/5 (BE)	71.9	4.0	15.0	20.9	26.3	36.6	30.6	42.6

PA = Provisional actuals. BE = Budget estimates.
Source: State Bank of Pakistan, *Annual Report 1994–95* (Karachi: SBP, 1995).

government deficit through subscriptions to government loans would be non-inflationary. Suppose, however, the banking system acquires cash for the purpose of subscription to government loans not out of maturing loans and investments, but through fresh deposits which it receives in consequence of depositors receiving additional incomes (which is liable to happen when disbursements exceed revenues raised by the government); the subscription to government loans will have taken place without reducing the existing investment in government securities (i.e. it would be net addition to resources lent to the government) and without reducing the existing volume of loans. In this situation, the process is inflationary, for the proceeds of loans when spent constitute a net addition to the amount of private purchasing power.

In the case of borrowing from the State Bank of Pakistan for financing the budgetary deficit, the process is clearly inflationary because the proceeds of borrowing when spent go directly to enlarge the cash basis (including deposits with SBP) of the commercial banks. Not only has the initial step of meeting the deficit through central bank borrowing increased the volume of private purchasing power, but the direct expansion of the cash of the commercial banks enlarges their ability to contribute to additional government loans or to make further advances.

In order to understand fiscal choices for the coming years, there has to be a clear understanding of the connotation of 'sustainable deficit'. This can be defined simply as the deficit level that can be financed without adding to the country's overall debt burden as a proportion of GDP, and without violating the government's macro objectives such as low inflation and real economic growth at the socially warranted rate, which in our case is at least 6.5 per cent per annum.

On the basis of studies conducted by the International Monetary Fund and the Ministry of Finance it appears that a fiscal deficit in excess of 4 per cent of GDP could have adverse macro-economic consequences including the danger of the economy sliding into the delirium of high inflation.

It has to be appreciated that the government's ability to create additional debt for financing the budgetary deficit is considerably constrained by the existing high level of indebtedness which at the end of 1993/94 constituted 88.4 per cent of GDP. The demand for Government debt could decline, if as a result of Government debt burden, the lender's confidence in the ability of the Government to faithfully fulfil its obligations in this regard is shaken or there is a fear of sharp erosion in the purchasing power of the rupee. In such a situation, the Government would also be forced to sharply raise its interest rates or further crowd out private investment.

In case the Government finds itself unable to increase its non-bank borrowing or cut its spending or enhance revenues by means of taxation, there is only one option: to monetize the deficit and collect a higher inflation tax. The scope of mobilizing additional revenues through inflation, however, is significantly reduced on account of the removal of restrictions on capital flows from Pakistan as well as foreign currency holdings by domestic residents. Expectations of an increase in the rate of inflation in the future would lead to acceleration in the pace of currency substitution, thus shrinking the Government's inflation tax base.

The need for reducing fiscal deficit to a sustainable level is thus clearly indicated.

Source: *The News*, Karachi, Business and Finance Review, 6 May 1995.

Appendix 11.2

Public Debt Reconsidered

After the Nawaz Sharif government was returned to power in February 1997, it launched the 'National Debt Retirement Programme', and emphasis returned to the recurrent problem of public debt. Here we present a different view of the issue.

The issue of Pakistan's public debt has returned to the top of the economic agenda yet again. The country's two leading monthly magazines have devoted their cover stories to the problem of the 'exploding debt bomb', and a number of articles, many by eminent economists, have appeared in the press reiterating the claim that the problem of Pakistan's debt burden is the single biggest economic problem facing the country today. Moreover, the Prime Minister's National Debt Retirement Programme, an attempt to involve the public and capitalise on their patriotism and enthusiasm, is part of the same scheme of things, where it is hoped that the public will help ease the burden of debt upon the government, by reaching well into their own pockets and contributing to the government's coffers.

If ever there was consensus on one single issue of importance amongst economists, bureaucrats, and politicians, then it must be over the agreement about the huge and growing debt and upon its consequences. However, I will argue that this focus is misplaced. In the light of such sentiment which constitutes much of conventional wisdom, it is necessary to consider the importance of the debt and expose a number of myths which constitute this feeling.

The facts regarding Pakistan's debt, however, are indeed quite startling. Pakistan's domestic debt has accumulated to more than Rs. 900 billion, or 42 per cent of GDP, with debt servicing accounting for more than 5 per cent of GNP each year. The rate at which this debt has been raised is on the high side, with interest rates in nominal terms around 16 to 18 per cent, or between 4 to 6 per cent if we assume a (very conservative and undervalued) rate of inflation of around 12 per cent. Foreign debt accounts for about US$30 billion (46 per cent of GDP), but for the most part, carries a far lower, single digit rate of interest. Much of this is longer term debt, and despite Pakistan's immediate needs to meet some repayments which come due over the next nine months, the more serious and chronic problem is considered to be that of domestic debt.

Because of the large domestic debt, interest payments are high, and due to this, we end up having a large fiscal deficit each year. Interest payments and defence take up almost all of the budgeted annual expenditure, leaving very little for development and the social sectors. Given the excessive debt that has accumulated over the last few years, it is not likely that any recourse to patriotism will result in more than a minuscule amount being pocketed and the debt 'burden' or 'problem' is unlikely to go away for a long time to come. Given this fact, it is important to consider the other 'villain' of the piece, the fiscal deficit, and see what sort of impact that has on the economy.

Although many analysts frequently talk about Pakistan's annual fiscal deficit, and the IMF insists that it be reduced from the currently estimated 6.3 per cent of the GDP to 4 per cent by June this year (an irrational and ridiculous imposition, to say the least, and an impossibility, no doubt), what is often overlooked is the fact that the Primary Budget Deficit has been negative for the last few years. What this means is that in terms of the simple revenue/expenditure divide, if we exclude interest payments accumulated on past debt, then revenue, for the last three years, has been greater than expenditure. However, lest this fact result in an immediate cheer, it is necessary to point out that this positive balance over the last few years is not simply due to additions in revenue, but also due to larger cuts in expenditure.

In the current fiscal year alone, the original allocation for the annual development programme was reduced by 19 per cent from a mere Rs. 105 billion to a dismal Rs. 85 billion, by the caretaker government of Shahid Javed Burki. As Burki in a much cited article himself confessed, 'if this figure is finally realized, Pakistan would have scored another low in its economic history in terms of the proportion of gross domestic product committed to development'. In order to cut the fiscal deficit and be as close to the 4 per cent target proposed by the IMF and endorsed by the caretaker government between November 1996–February 1997, this year 1996–97, Pakistan's development expenditure will be no more than 3.4 per cent of GDP, down from a peak of 9.3 per cent a little over a decade ago. More interesting, however, has been the contrast in the pattern of expenditure on development with that on defence since 1980. Over the period 1980–90 when a military dictator ruled Pakistan for much of the decade, defence expenditure averaged around 6.5 per cent of GDP, with development getting 7.3 per cent. Currently, development receives less than half of what it got in the eighties, and receives only 3.4 per cent, while defence receives almost 6 per cent. Hence the composition of government expenditure is a critical factor overlooked by those who advocate its reduction.

If the question of the debt burden is to be considered, the fiscal deficit forms an important part of the equation. And, if the fiscal deficit is of importance, then we must examine the nature and the productivity of government expenditure, not simply its level or even the size of the deficit. This is the first factor ignored when issues of public debt are debated. To re-emphasize the point, we argue that it is not borrowing as such which is the problem, but the use made of borrowed money. The argument is valid both for domestic and foreign loans.

The problem then, is not to tell government to reduce its spending, as the IMF insists all governments should do at all times, under all circumstances, nor even the matter that government's try their utmost to raise taxes, as has been the case with ever increasing taxation in Pakistan in the recent past, but what is imperative is that government expenditure be productive. The essential and minimum requirement is the need to hold government accountable for spending productively. One of the many reasons why Pakistanis refuse

to pay taxes is that they feel cheated by government, in that they feel that their contribution to the exchequer is being squandered away. People may agree to pay more taxes only if they felt that their money was being used productively.

Another important caveat to the debt burden issue, linked to the efficient and productive use of expenditure, is the relationship between borrowing and growth. If the real rate of growth of the economy is greater than the real rate of interest at which government borrows, the problem is not a serious one at all. If economic growth can be sustained at around 7 to 9 per cent, a number of problems which persist in the economy and are related to the debt/deficit issue will cease to exist. Firstly, a higher growth rate should generate a higher level of revenue to the government, both from direct and indirect sources. In fact, this is one of the assumptions which are inbuilt into the economic revival package of Prime Minister Nawaz Sharif announced last week. Secondly, the government can continue to borrow as long as the differential between the rate of growth and the rate of borrowing remains positive. Finally, higher growth may generate more investable funds for the economy, possibly also lowering the interest rate. In all this, a check by government on prices and on interest rates would be extremely useful as well.

It is unlikely that all of Pakistan's debt will ever be retired, and what needs to be put in focus is the current fiscal deficit, and particularly, the use made of government spending each year. Nevertheless, the large amount of accumulated debt in the past cannot be ignored, and it is essential that an evaluation be made of the use to which loans taken in the past have been put. Much of fiscal policy in Pakistan, which has resulted in the high debt in the first place, has been ill-conceived, impractical, and downright irresponsible. Current proposals for reducing part of the debt, such as debt-for-equity swap, privatization proceeds set aside for this specific purpose, and the use of the begging bowl, may make a small dent in the amount of debt outstanding. However, so as not to make the same mistakes again in the future, those responsible for creating the problem in the first place must be held accountable. This is the bare minimum for the success of any long term viable economic reforms package. The rest is mere window dressing.

Source: Zaidi, S. Akbar, 'Focus on Debt Misplaced', *DAWN*, Economic and Business Review, 7–13 April 1997.

Appendix 11.3

Debt Retirement is a Waste of Money

What should the use of privatization proceeds be? Debt retirement or social sector development? Here we present one view.

There is an argument which has been floating around for a few months which has been propagated in the press by many learned and well-reputed journalists. The argument is based on the following facts: Pakistan's domestic debt has grown to gargantuan proportions and was Rs. 744 billion or 44.2 per cent of GDP at the beginning of the current fiscal year 1994–95, and is equal to our foreign debt. Thus, total debt was equal to 88.4 per cent of GDP. At the end of the current fiscal year 1994–95, domestic debt outstanding is expected to rise by a further Rs. 102 billion, taking the total domestic debt outstanding to Rs. 846 billion on 1 July 1995. Debt servicing in the current fiscal year was supposed to be Rs. 136 billion, of which Rs. 82.7 billion (60 per cent) was meant for interest payments on domestic debt alone and the remainder was distributed between foreign debt repayment and interest on foreign debt. It is believed that domestic debt and interest on it each year are serious problems facing our economy which lead to high inflation, low savings, and other sundry problems. These proponents believe that the high interest payments each year are causing a huge drain on our economic resources and should thus be reduced.

On the basis of the evidence presented above, the argument which is being made is that Pakistan must retire some of its debt if is to deal with the problem of high deficits and low growth and other repercussions. In this regard, it has been suggested that the proceeds from privatization should be earmarked for debt retirement. In the current fiscal year, in excess of Rs. 40 billion were accumulated by the government through its privatization programme, and next year, the government hopes to acquire Rs. 100 billion from the privatization of 26 per cent shares of PTC alone. If UBL and Habib Bank are also privatized over the next couple of years, the government can hope to receive considerably more. Proponents of the debt retirement view believe that by using these privatization proceeds, the problem of domestic debt and its annual interest bearing component can be dealt with. However, this view is highly fallacious for reasons that I make clear below.

Some facts other than those presented above will help make things clear. Each year based on the trend since 1990 on average, Rs. 74 billion is added to our domestic debt. This year Rs. 102 billion will be added. In fiscal year 1994–95, Rs. 82.7 billion contributed towards interest payments on the domestic debt of Rs. 744 billion, which was 11 per cent of the total domestic debt outstanding. For the sake of argument, let us assume that the government of Pakistan, by some sleight of a magic wand is able to bring down the fiscal deficit to 4 per cent of GDP (from the likely 5.6 per cent this current fiscal year) and is able to maintain this level for the next three years. The critical point which most observers have missed is that even if the fiscal deficit is a mere 1 per cent of GDP—an impossible happening, no doubt—the debt will still grow and accumulate.

Let us construct a highly favourable scenario to illustrate our point. By using the proceeds from privatization for debt retirement, the following scenario takes place: First, let us assume that GDP is Rs. 1,847 billion at the end of this year

Table 1
(All in billion rupees)

	1995/6	1996/7	1997/8
Gross domestic product (with an annual growth of 6% per annum)	1,847	1,957	2,075
Fiscal deficit (at 4% of GDP)	73	78	83
Domestic debt outstanding	846	919	998
Interest payment without retirement (at 11% of domestic debt)	93	101	109
Domestic debt after debt retirement	846–100=746	819–100=719	797–100=697
Interest payments after debt retirement (at 11%)	82	79	77
Domestic debt for next year	746+73=819	719+78=797	697+83=780

Total interest payments without debt repayment of Rs. 100 bn for three consecutive years:
93 + 101 + 109 = 303 bn
With debt repayment of 300 bn:
82 + 79 + 77 = 238 bn
Net difference = Rs. 65 bn
By spending RS300 bn, the government saves Rs. 65 bn.

and grows at a constant high rate of 6 per cent over the next three years. Along with this favourable growth rate, we also assume that the government achieves its target of a fiscal deficit of 4 per cent of GDP over the next three years. This means that GDP will grow from Rs. 1,847 billion at the end of this fiscal year to Rs. 1,957 billion next year and to Rs. 2,075 billion for our third year of analysis. Similarly, the fiscal deficit in these three years at the rate of 4 per cent of GDP will be Rs. 73.9 billion, Rs. 78.3 billion, and Rs. 83.0 billion [see Table 1].

What is important here is that each year a considerable amount (4 per cent of GDP which accrues in the form of the annual fiscal deficit) is being accumulated as part of the domestic debt and is being added to it. Now let us examine the repercussion on interest payments each year. The total debt in our scenario increases from the present Rs. 744 billion, to Rs. 846 billion at the start of the next fiscal year, and then to Rs. 919.88 billion and finally to Rs. 998 billion at the end of three years. If we take the current rate of repayment of domestic interest, which is 11 per cent of domestic debt outstanding, we have the following figures for interest payments for the next three years: Rs. 93.06 billion, Rs. 101.18 billion and Rs. 109.8 billion in the third year when our domestic debt should have grown to Rs. 998 billion.

Although we have not introduced the possibility of debt retirement in our argument as yet, based on the above highly positive economic growth and management scenario, the following picture emerges: despite excellent management and control of the economy, total domestic debt increases by more than Rs. 73 billion each year, and interest payments on domestic debt alone will exceed Rs. 100 billion. Let us now bring debt retirement into the picture.

Let us also take a highly favourable scenario regarding debt retirement and assume that in each of the next three years, the government will amass the considerable amount of Rs. 100 billion from the sale of state owned enterprises and will use this amount exclusively for debt retirement. As can be seen from the table, despite such an extensive amount being retired each year, the net difference in interest repayment on the domestic debt would only be Rs. 11 billion each year, and we would still be paying more than Rs. 80 billion in interest on the earlier accumulated domestic debt alone.

The proponents of the debt retirement view have failed to distinguish between the concept of debt (which is a stock) and deficit (which is a flow and is added each year to the debt). They have also overlooked the fact that debt retirement of a huge amount of Rs. 100 billion each year will only make a very small, negligible net contribution at the margin. By giving up Rs. 100 billion, we will be left with a gain of Rs. 11 billion only. The privatization proceeds should be used for direct development projects rather than debt retirement, which will be a total waste of money.

Source: Zaidi, S. Akbar, 'Debt Retirement is a Waste of Money', *The News*, Karachi, 28 June 1995.

NOTES

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58. Kemal, A R, 'Debt Accumulation and its Implications for Growth and Poverty', *The Pakistan Development Review*, vol. 40, no. 4, 2001, 267.
59. Ibid.
60. Sherani, Sakib, op. cit., 44.

Part 4

Devolution and Fiscal Federalism

Devolution, decentralization, delegation, and similar concepts related to granting more autonomy to sub-national administrative units, are now in much use as there has been a realisation, or at least an assumption, that smaller administrative units are better placed to deliver on social development and welfare. Local governments, especially, are perceived to be better-equipped to address the needs of the people with whom they interact. Moreover, assumptions are also made that, since local governments are 'closer' to the people they are expected to serve, they are also more accountable, and people in general have more control over such entities. This is the assumption even when local governments are not elected, but if they are elected, then there is supposed to be even greater accountability.

The irony in Pakistan's history, and there have been far too many, is that elected local governments have almost exclusively been the choice of military dictators, of which again, there have been far too many in the last sixty-six years. All three of Pakistan's military generals—Ayub, Zia, and Musharraf—proposed their own systems of elected local government as soon as they came to power. In contrast, when (real) elections were held for the Provincial and National Assemblies in Pakistan and parliament was elected, the elected governments at the centre or the provincial level, all did away with the elected system of the previous military dictators, not replacing those systems with their own. Hence, military dictators preferred elected local government under the guise of praetorian democracy at the federal and provincial level, while elected members of the National and Provincial Assemblies preferred to have administrators imposed as local government heads. This latter apparent contradiction explains the power of local government, where elected provincial members see it in conflict with their own sources of power. They undermine elected local government to enforce their own power.

These two chapters examine how different systems of local government have evolved in Pakistan and how they have performed. They also reveal that despite the proclamation that power had been devolved to the local level as General Musharraf often stated with regard to his District Government system, such 'power' was a fiction without the devolution of financial resources. Even if local government performed well in some cases, their lack of fiscal autonomy undermined their efficacy.

Chapter 13 discusses what just might be one of the more radical aspects of fiscal federalism and of provincial autonomy ever granted to Pakistan's sub-national units, after the 18th Amendment in the Constitution. Although it is four years since the passing of the 18th Amendment, as well as after the Seventh National Finance Commission Award, and there are many features of both which are incomplete and in contradiction with each other, Pakistan's administrative system, as well as its financial one, has been radically altered. Provinces now have become far more important, and richer, than ever before especially in terms of social sector development, although they may not yet have the human resources or skills required to deal with these new responsibilities.

12 Local Government and the Political Economy of Decentralization[1]

The decentralization, devolution, and deconcentration of power and the mechanism of delivery of services, undertaken separately or in some combination of all three, particularly in developing countries, has become the mantra of administrative, managerial and governance related interventions and reforms. Development theory and its practices, are no longer conceived to be seen as the prerogative of a strong, centralized state but, rather, smaller and more representative administrative and political units are presumed to be better at delivering and implementing development. Not only have the structures and the role of the state changed in administrative terms, but there has also been a simultaneous realization that forms of democracy and participation are essential to make development work. Perhaps over the last half century, these two notions, of devolving power and delivery along with the greater participation by the people, have become the *sine qua non* of development.

There has been a considerable and diverse response by international financial institutions, development agencies, donors, and independent governments to these two core changes that have been brought about over recent decades, and in particular after the fall of the Berlin Wall in 1989. In projects devised by donors and international development agencies, for example, some component of community participation and civil society participation has become a prerequisite for loans to be disbursed. In other contexts, due to social and political change that has taken place over the years, forms of people's power have emerged as one of the forces that not just respond to state-led initiatives, but actually lead them, as in the case of the Philippines and South Africa. In other countries where there has been a deep and growing tradition of formal politics and electioneering, as in India, civil society groups have played a significant role in countering formal democratic politics, offering solutions which are more suited to the responses of diverse communities. In other cases, development agencies have been able to persuade and, perhaps even force, governments to undertake reforms to restructure their government and state institutions. The effective role of civil society in redefining politics and property relations, as well as reconfiguring the state in its entirety, is best demonstrated by events and processes that unfolded in the late 1980s and early 1990s across Eastern Europe, led mainly by civil society groups. The case of Pakistan discussed in this chapter, in many interesting and critical ways, differs considerably from these numerous other experiences, and emerges as an interesting case-study which runs against the grain of many of the patterns observed across the globe.

The purpose of this chapter is to explore broadly, the decentralization and devolution debate and experience in Pakistan, in a political economy framework and context, with emphasis on contextualising power and examining issues of devolution and decentralization within a wider framework and context of state-society relations.[2] An attempt will be made to keep the debates on devolution in Pakistan embedded in a wider debate on postcolonial state-society relations and their context, with discussion on the meaning of the state to the ordinary people, and examining earlier experiences of devolution and decentralization. The changing nature of the Pakistani state, its class formation, and the nature of politics that emerges for participation, democracy, and civil society institutions, in a much wider context and not simply related to decentralization and devolution in a local government context, will need to be explored, so that one can locate the specific issues of local government and local power relations within the broad structure of state, class and transition—also see Chapter 26 and 27. Clearly, the main contribution of this chapter is that it follows this particular political economy approach and framework which requires a broader, more holistic view, and distances itself from a purely administrative/managerial/governance-related evaluation. This is an important conceptual point which needs to be understood and emphasized in order to get a full flavour of experiences, possibilities, and constraints within the context of this chapter.

The chapter will also include a discussion of identified strengths and weaknesses of devolution schemes with suggestions for further research. Its focus is on examining the political and institutional set-up of devolution and local government in Pakistan in a historical context looking at key issues as they exist.

This chapter makes use of the very extensive recent literature that has emerged on devolution and decentralization in the context of local government reform in Pakistan, as well as on the nature of the political economy of the state, classes and on the political settlement in Pakistan. It is important to point out that while we examine the historical evolution of decentralization, devolution, and local government in the broader political economy context, we are more concerned with recent—post 1999—events and attempts at reform than with earlier attempts, although we do discuss earlier processes in some detail as well. Within the literature on local government reform, there are two broad strands, one of which deals with administrative, managerial, financial and largely governance-related studies, many commissioned by donor agencies and undertaken by international financial

agencies and donors themselves, all in recent years after the takeover of the Musharraf regime in October 1999.[3] The other, more recent and in our opinion, far more interesting and creative work has emerged in light of examining the political economy nature of decentralization, looking at issues of class and state.[4] Linked to and prior to this, is the recent academic literature which has emerged and which examines issues related to the broader political economy of the Pakistani state—also see Chapters 26 and 27.[5]

12.1 Local Government in Pakistan

Given the broad scope and interest of this chapter, this is not a chapter which simply recounts a secular account of developments that have taken place with regard to decentralization as the history of local government. Its concern is more with contemporary issues post-1999, hence it focuses more on recent developments and the wider context in which they have taken place. The chapter begins with a brief account of previous attempts at decentralization in Pakistan and then leads on to developments over the period 1999–2005.

There have been three substantive interventions in the decentralization and devolution process and structure in Pakistan since 1947, manifest through different administrative structures of local government. While all three differ substantially from each other in substance and structure, they share many similarities, most importantly, in intention. The fact that all the three attempts at local government reform in the form of decentralization and devolution have been undertaken not just by undemocratic, unrepresentative, unelected governments, but by the three military governments which have taken power through force, gives the narrative in Pakistan a very different twist compared to other experiences. In fact, the irony of the history of local government reform in Pakistan has been that the three military governments which have ruled Pakistan directly for 33 of its 66 years since independence—and half as many years behind the scenes—have aggressively supported this process of devolution, while all elected governments have consciously undermined this tier of government. This contradiction, between democratic politics and the military's politics, perhaps underlies not just discussion about devolution and local government reform, but discussion about the state, society and politics in Pakistan.

This chapter begins with a presentation of the political and structural context of the 1959 local government reforms, known as the Basic Democracies system of General Ayub Khan. Section 12.1.2 then moves on to an analysis of the political, social demographic and institutional context of Pakistan's second military regime, that of General Zia ul-Haq and his local government system, a system that continued for eleven years even after Zia's death. Clearly, over a period of two decades between each set of reforms, there had been substantial demographic and social change in Pakistan, a fact that is also reflected in the nature of the local government reforms undertaken as well as in the nature of politics. Then, in Section 12.1.3 we look at the District Government system under General Musharraf, again in a broad political economy framework identifying key political issues that have emerged in the new millennium. In fact, one of the key underlying arguments and strands to the analysis in this chapter is, that it was political changes as well as socio-economic ones, around which the evolution of the local government system took place. Section 12.2 deals with financial issues related to local government, since the performance of local government has been very dependent on the availability of funds available to make it work. In this section we examine how financial issues have helped or hindered service delivery at a devolved level. Finally, in Section 12.3, we evaluate the politics of the devolution and decentralization process in Pakistan in recent years.

12.1.1 The Basic Democracies of the 1960s[6]

Coming in to existence on 14 August 1947 as an independent state, created out of the partition of British India, Pakistan emerged as a geographical entity and a country, but perhaps, a country without a well-formed state. It inherited the bureaucratic steel frame of British India which continued for many decades. The ruling groups of politicians and administrators had migrated from areas that became India, and in many ways were alien to the areas that became (West) Pakistan, one of the few explanations as to why democratic forms of government never took hold in Pakistan. Landlords and bureaucrats formed the broad nexus of rulers in Pakistan, which had little industry and no middle class. The political bodies constituted to undertake some form of constitutional reform, never agreed to any system or Constitution which could be put in place. In this political and institutional arrangement, the most important actor was Pakistan's military. Hence, in the first decade of Pakistan's existence, politicians were unable to come to political agreements and settlements, with different unelected groups of politicians being replaced by the head of state. Pakistan lacked adequate infrastructure, was highly rural and underdeveloped. Many of the country's problems were aggravated by the movement of 7 million refugees who came from India after partition, and rehabilitating them was Pakistan's first development problem. In a state which was far from modern, it was the two most modern institutions, the bureaucracy and the military, which set Pakistan on course towards a path of development, but also on a path, which in contrast to independent India, led from one military rule to another.

Douglas E. Ashford, writing in 1967, when General Ayub Khan was still very much in power, and soon to celebrate his Decade of Development, after examining two other cases of local government reform, wrote:

> The elaborate system of councils organized by the Pakistani military-bureaucratic oligarchy is certainly the most ambitious of the three schemes for local reform. . . . The ruling oligarchy has made local reforms the keystone of its domestic policy, and President Ayub Khan has regarded the Basic Democracies program as his most important reform.[7]

We will find in other sections where we talk about the two sets of reforms undertaken later, that exactly this sentiment was expressed by the two other military rulers in Pakistan as well. Ashford utters a hugely misplaced and preposterous statement about the Ayub regime which has also been repeated in other contexts almost forty years later: 'the Ayub regime has shown itself to be seriously and energetically devoted to the restoration of civilian government'.[8] However, there were not many in Pakistan who shared this feeling.

General Ayub Khan imposed the first Martial Law in Pakistan in 1958 and took over government from a group of politicians who were unable to resolve their differences, clearly not an uncommon occurrence in societies where issues take time to be resolved through dialogue and discussion. Ayub disbanded all previous partial political systems of government as they existed and restrained politicians through draconian measures. It is worth quoting Ashford again just for the absurdity of a statement which one finds repeated over time:

> With true professional perspective the president saw that irresponsible politics at the centre, and the consequent corruption and economic stagnation could only be prevented if new leadership was introduced and a more solid basis for political participation was constructed. His answer was the Basic Democracies plan, which was to provide an interlude for village instruction and revival.[9]

With the dissolution of all forms of representative government and with curbs on politicians, General Ayub initiated the structure and system of a form of devolution and decentralization which resulted in the system of local government in the guise of Basic Democracies. The Basic Democracies Order appeared in October 1959 and two months later Basic Democrats were elected. In April 1960, the Municipal Administration Ordinance specifically for urban areas was enacted, giving rise to what some observers think was an 'integrated pattern of urbo-rural local government in Pakistan'.[10]

The Basic Democracies Order 1959 envisaged a new system of local government built up through a hierarchical four-tier system. The 37,959 villages in Pakistan were divided into Union Councils in rural areas and Town Committees (in towns with less than 14,000 inhabitants) and Union Committees in towns with more than 14,000 inhabitants, at the lowest tier in the structure. The next higher tier was that of Tehsil Councils in rural areas and Municipal Committees and Cantonment Boards in urban areas, followed by District Councils and finally Divisional Councils, the latter two of which covered both urban and rural areas.

It was the lowest tier, that of Union Councils, Town Committees, and Union Committees which had members elected on the basis of adult franchise, who then elected a chairman from amongst themselves. The higher tiers had some members which were indirectly elected by these directly elected members, as well as members nominated by government. For example, each Municipal Committee had a Council composed of all the chairmen of Union Committees within the Municipal Committee, as well as 'councillors representing special interest and the officials' which came from 'Nation Building Departments', such as education, health, agriculture, public works, etc.[11] It is important to note, that in this highly restricted participatory and electoral framework, the far more important figure of the chairman of the Municipal Committee was appointed by the government. In other cases, an Assistant Commissioner or Tehsildar would be the chairman, with a Deputy Commissioner the chairman of a District Council and the Commissioner heading a Divisional Council. Clearly, the 'controlling authority' in every case, was the bureaucracy and officials of the government.[12]

Ali Cheema and his colleagues argue that this controlling authority by the bureaucracy, 'had the power to quash proceedings; suspend resolutions passed or orders made by any local body; prohibit the doing of anything proposed to be done; and to require the local body to take some action'.[13] Quoting H. J. Friedman writing in 1960, and clearly at odds with Ashford cited above, they concur that 'the Basic Democracies Scheme is not, in reality, democracy, for it does not represent control by the people over government power except in an extremely limited manner'.[14]

Given the fact that a very large majority of Pakistanis lived in rural areas, the structure of the Basic Democracies system was perceived by many, to be able to undertake development related activities along with the ongoing Village AID (Agricultural and Industrial Development) programme, and in fact it did have an impact and along with Ayub's land reforms, did play a role in transforming rural economic and social structures and social relations of production; after all, the elections of Basic Democrats were the first Pakistan-level elections in its history. However, it was the use of the 80,000 Basic Democrats as an Electoral College for the election of the President to consolidate his own rule, which was the real issue.[15] The Basic Democrats became a constituency for the military and particularly for General Ayub and there was, as is always the case with politics, ample opportunity for corruption and for patronage. As we show on a number of occasions below, whenever democratic politics comes into contradiction with the military's politics, and especially when the military's local government is confronted with representation, the artificial system set up by the military comes undone. The military and participatory or democratic politics, despite the military's attempts, do not go together.

Ayub Khan's civilian and military bureaucratic regime was a developmentalist regime, with equal and substantial focus towards increasing production and capital in both urban and rural areas.[16] As we show in earlier chapters, both industrial and agricultural output saw phenomenal rates of growth and in many ways altered the social relations of production irreversibly. Although there is debate about the reasons for the land reform of 1959, whether it was undertaken to break the hold of the bickering political landowning class, or to provide an impetus to the process of capitalist agricultural development, the consequences of the reform were that both outcomes took place. The hold of the large landowners was indeed dented, but more importantly, the reforms and the numerous other interventions that took place in the agricultural sector brought about nothing less than a revolution in agricultural production and social relations

of production, and in fact altered the face of Pakistan once and for all. Shahid Javed Burki has argued that, towards the late 1950s, landlords were again emerging on the political horizon, and Ayub Khan's shifting of power from Karachi to the Punjab and Rawalpindi resulted in more representation for indigenous and rural Pakistan, which is one reason why agriculture gained prominence throughout the decade.[17]

The 1960s witnessed the emergence and consolidation of many political groups and economic classes. In agriculture, the hold of the large landowners may not have been broken, but it was certainly shaken enough to allow other economic categories to emerge. Many of the large landowners had the foresight to read the writing on the wall, and accepted the Green Revolution technology package introduced by the government. Although this was an élite farmer strategy, given the high costs associated with the purchase of tractors, the sinking of tube wells, and other ingredients of the package, state subsidization gave the middle farmers, too, the opportunity to adopt this technology. This was the essence of the Green Revolution: the middle and kulak farmers, along with many other farmers at both ends of the spectrum, emerged as capitalist farmers, soon to become a dominant economic and political force in agriculture and in the country.

In the rural areas, alongside this emerging capitalist farmer we also see the genesis of the small-scale manufacturers, and the skilled and technical workers, the growth of an ancillary service sector in order to service the new economy, and a disenfranchised, landless agricultural wage-labour class. To some extent, the political ambitions of the newly emerging agricultural capitalists were accommodated in the Basic Democracies scheme of Ayub Khan, but without giving them any real political power. This was perhaps the beginning of the apprenticeship of this class of rural politicians, which was to emerge, especially in the Punjab, in the 1970s and was to stamp its mark on the political economy of the country. The military and civilian bureaucrats under Ayub 'had forged a strong political alliance with a number of middle class urban and rural groups', which helped in fostering economic development and political participation. Moreover, the Basic Democracies system 'not only gave a voice to the middle class peasantry of Punjab and the NWFP, but also converted Pakistan's powerful civil bureaucracy from an apparatus for maintaining law and order into a remarkable vehicle for promoting development'.[18]

In essence then, as social transformation took place, with increased urbanization and with the emergence of different factions of the middle class, with rural to urban migration rising, these processes came into contradiction with the structure of government established by Ayub—and not just the Basic Democracies system, but the whole edifice—came crumbling down. Once an originally designed 'non-political' governance structure came into contradiction with the wider politics of the time, it was not able to function adequately, if ever it did, with its bureaucratic authoritarianism which may have become, at times, a softer, benevolent bureaucratism.

The Basic Democracies system was, and was seen to be, one of the most important initiatives of the Ayub regime and was perceived to be closely tied to him. As Rizvi states,

> the political super-structure of Ayub Government rested on the foundations of Basic Democracies, a political system which reflected the political philosophy both of the soldiers and the bureaucrats'.[19] Once the broader political structure of the Ayub regime began to collapse, as it happens so often in Pakistan, many of the initiatives of a fallen regime are removed with it. Such was the case of the Basic Democracies system. With the system in abeyance under General Yahya Khan who replaced Ayub after he surrendered to the political forces let loose by the process of demographic and social change, it took the newly elected President, Zulfikar Ali Bhutto, to say a few days after assuming power in 1971, that 'I am abandoning the system of Basic Democracy that has bred nothing but nepotism and corruption, a system that reduced democracy to a farce.[20]

The democratically elected Bhutto promised to introduce a better system of local government. Although two Local Government Ordinances were introduced in 1972 and in 1975, there was no implementation of any sort of local government, and despite the doing away of the Ayub era's model, in many ways the unrepresentative structure of implementing government at the local level—largely through the bureaucratic structure—remained. There were, of course, huge differences between the 1970s and the 1960s, not least because there was an active cadre of political workers at all levels of governmental and civil society levels, most of them members of political parties, who were involved in some form of intervention in development. Rather than a formal structure as under Ayub, there was a greater *awami* and populist culture of government, at times tending towards authoritarianism. In fact, it was this politicization of politics that probably stopped Bhutto—like other civilian governments after him—to undertake any real reform at the local level. Ali Cheema and Shandana Mohmand argue that Bhutto did not want to undertake local government reform due to the

> fear of losing local support in key areas to competing mass-based regional parties. . . . Perversely, the rise of competing mass and cadre-based parties and the increase in electoral competition at the provincial and local level in 1970 made Bhutto more reluctant to actually decentralize power to the local tier.[21]

Nevertheless, for our purposes, we can conclude that the first democratically elected government in Pakistan did not bother to introduce a system of representative local government, and even the Constitution of Pakistan of 1973 agreed to in this period by all political parties, those in government and those in the opposition, failed to allot local government recognition as the formal, third tier of government in Pakistan. This is one of the many ironies that crops up across time in Pakistan.

12.1.2 Local Government in the 1980s (and 1990s)[22]: Urban Pakistan and the Middle Classes

With the imposition of Martial Law following Pakistan's second military coup and under its third military government in 1977, all political activities, as they had, almost two decades earlier, come to a stop. While General Zia ul-Haq promised elections within ninety days and did initially allow some political campaigning to take place, it was soon clear to most, that Pakistan was once again ready for the long haul under military rule. The national and provincial assemblies had been disbanded and the stage was set for the revival of all military government's favourite hobby-horse, that of some form of devolution and decentralization in the guise of a structure of local government. Exactly 20 years after Pakistan's first attempt at devolution following the Basic Democracies Order of 1959, the Local Government Ordinance (LGO) of 1979 were promulgated and elections were held to elect local councillors. Ali Cheema and Shandana Mohmand argue that like Ayub Khan,

> Zia ul-Haq combined political centralization in the hands of the army at the federal and provincial levels with a legitimization strategy that revived electoral representation at the local level. . . . History was repeated as non-representative political centralization and the revival of local governments again came at the expense of weakening the elected tiers at the federal and provincial levels.[23]

However, Pakistan was a very different country now than it was 20 years earlier.

For purposes of brevity, if we were just to identify some of the critical differences between 1959 and 1979, perhaps the single most important would be that Pakistan was half the country in 1979 compared to 1959 following the secession of East Pakistan, the majority province, to emerge as independent Bangladesh in 1971. Pakistan over these two decades had also become increasingly urban, certainly not in statistical terms, but in terms of influences and culture one could see the beginnings of an urban Pakistan, something that was to be further strengthened during the 1980s. So called 'feudal' agrarian social and economic structures and relations had also given way to more modern capitalist relations of production and exchange, following the Green Revolution, the implementation of two sets of land reforms, and with the mechanization of agrarian production. In 1979, one also sees the beginnings of the consolidation of the middle classes as political and economic actors, something that was further strengthened throughout the 1980s due to economic developments, particularly the Gulf boom over that decade. Importantly, the structure and system of local government introduced in 1979 also strengthened the role and position of the middle classes in Pakistan. Another critical difference between Pakistan in 1959 and 1979 had been that in the decade prior to the 1979 local government reforms, the Pakistani people had participated in two rounds of General Elections and some forms of democracy, however muted, had taken root. People had now experienced, and perhaps begun to understand, the meaning of participation and democracy. One needs to understand the Local Government Ordinance 1979, in light of these circumstances, and the consequences that the Ordinance let loose are predicated upon the conditions which existed at that time.

The Local Government System under the LGO 1979

In the Constitution of Pakistan 1973, which was suspended and in abeyance during the earlier part of General Zia's regime, the allocations of the functions of the federal and provincial governments are clearly specified. There are some functions which are the exclusive responsibility of the federal government, while others, according to the Constitution can either be performed by the federal or provincial governments. However, the existence of local governments was never formally embodied in the Constitution.

Local governments in Pakistan existed under the supervision of the various provincial governments, where provincial governments had merely delegated some of their functions and responsibilities to local governments by the promulgation of ordinances. The Local Government Ordinance of 1979, with its amendments was in operation in the Punjab, Sindh, and the NWFP, while Balochistan's local governments worked under the 1980 Ordinance. These ordinances specified the allocation of the residuary functions of local governments.

Under this Ordinance, in the urban areas there were four levels of municipal government—Town Committees, Municipal Committees, Municipal Corporations, and Metropolitan Corporations. The senior officers of these councils were elected by members of the council and the controlling authority was the elected house. There was a three tier system of local government in operation in Pakistan in the rural areas, where Union Councils, Tehsil or Taluka Councils, and District Councils existed. However, the middle tier, the Tehsil/Taluka level was usually done away with in practice by provincial government, and mainly Union Councils and District Councils existed, which were elected on the basis of adult franchise. The chairmen of these councils were elected by the elected members themselves.

The Local Government Ordinance specified two sets of functions to be performed by local governments. The differentiation between the two sets was between compulsory and optional functions. For the most past, most of the sets of functions for local governments in different provinces were more or less the same. There was further differentiation between the functions of a regulatory nature, and those that relate to the provision of services.

For the three larger provinces, a common list for all urban councils containing compulsory and optional functions existed. Thus, Town Committees, Municipal Committees, Municipal Corporations and Metropolitan Corporations (with the exception of Karachi) were supposed to perform the same functions.[24] The Karachi Metropolitan Corporation had been given additional functions. Due to the limited extent of urbanization in Balochistan, a smaller list of functions

existed for Town Committees. While there was a great deal of similarity of functions between the provinces, there were a few minor differences between what is deemed compulsory and optional. The largest Metropolitan Corporation in Pakistan, that of Karachi, had some additional responsibilities.

Like their urban counterpart, a long list of functions for the two-tiered, rural, local government also existed. Union Councillors were expected to perform civil, welfare, and development functions. The civil functions included the provision and maintenance of public ways, sanitation, and conservancy; the slaughter of animals; and the maintenance of wells, water pumps, and tanks. If calamities struck, the Union Councils were expected to undertake relief measures and other measures to promote welfare and health. The development functions of the Council included measures to increase food production, industry, and promote community development. The District Councils had optional and compulsory functions. Compulsory functions included the provision and maintenance of roads, bridges, public buildings, water supply, maintenance and management of hospitals, maintenance and construction of school buildings, etc. Many of the optional functions of District Councils were similar to those of Town Committees.

The Local Government Ordinances specified that a local area in the context of urban areas would be a town, municipality, city or metropolis; the corresponding local government was a Town Committee, Municipal Committee, Municipal Corporation and Metropolitan Corporation. Municipal status was primarily a function of population. Urban settlements with population ranging from 5,000 to 30,000 were generally designated as Town Committees. Municipal Committees had populations up to 250,000. Cities beyond that size and provincial capitals had either Municipal or Metropolitan Corporation status. Property tax rating areas generally extended to the Municipal Committees and the larger town committees. The status of local government functionaries was directly correlated with municipal status of the particular jurisdiction. While the number of councils varied, for the most part, there were two Metropolitan Corporations, 12 Municipal Corporations, 146 Municipal Committees, and 336 Town Committees functioning in Pakistan.

In urban areas, the four types of Municipal Committees had organizational setups which were more or less similar across the provinces. Despite the fact that urban Union Councils, from the Town Committee to the Municipal Corporations varied in size, and the latter may have been as much as a hundred times the size of the former, there were very clear similarities in organizational structure. There were always three sections or departments comprising general administration, finance, and engineering. Town Committees had just these three departments which grew in size and qualitative specialization as the size of the urban area increased, i.e. when it was represented by a municipal committee or corporation. Municipal Committees and Corporations were also very similar in the nature of their organizational structures, and both had two additional departments, viz. education and health. Furthermore, the accounts department consisted of two separate units, one for finance and the other for taxation.

The two Metropolitan Corporations of Lahore and Karachi, by virtue of their size had far more diverse and extensive organizational structures. For example, given the extensive nature of types of works which were to be performed in metropolitan areas, there was a need for additional departments which performed specialized functions pertaining to legal affairs, land management and development, etc. The larger Municipal Corporations in the country, along with the two Metropolitan Corporations also had development authorities functioning as parallel organizations within the cities. However, while the urban local councils performed more service related functions, the development authorities were more involved with engineering works and with urban and town planning as well as with traffic related issues.

Despite the large number of legislative functions of local councils and their often extensive organization and management structures, *very few functions by local councils were actually carried out*. In urban areas, essentially three basic (compulsory) services were carried out—garbage disposal, maintenance of roads and street lighting. In the larger cities, preventive health care was looked after by local government, which was beyond the scope of smaller urban councils. Most urban local councils were involved in the maintenance of water and sanitation services. Essentially, urban local councils had restricted their role to some of the compulsory functions which they were expected to perform. In smaller cities, even these compulsory functions had been unfulfilled by the local council because they either did not have the funds or knew how to undertake the compulsory functions.

In rural areas, the actual role of Union Councils and District Councils was even more limited than the role played by smaller urban councils. Some District Councils were involved in the development and maintenance of link roads and drainage, and that is about all. Union Councils had virtually no role in the development or maintenance of services. The larger District Councils had a partial involvement in the provision of preventive and curative health care and in animal husbandry.

Under the Local Government Ordinances of 1979, elections of all local bodies were to take place on an adult franchise basis, and did, in 1979 and 1983—for the story after that, see below. After the elections of all the members of a unit, the Chairmen, Vice Chairmen, and Mayors were all elected from amongst the members of the local council. The membership of each council was determined on the basis of the distribution of population in that region. There was some separate representation for non-Muslims, peasants, workers, and women, who were all to be elected by the members of the councils.

The degree of electoral representation—seats to population ratio—was highest at the lowest level of local government, the Union Council level, in rural areas. There was a maximum number of seats prescribed for district councils and municipal corporations in some provinces, which implied that the number of seats rose less than proportionately with respect to population. Close to 80,000 seats were contested in the local government elections, of which 89 per cent of the representatives sat in rural local councils, with 84 per cent in Union Councils. Since Punjab had the greatest share of

Pakistan's population, it also had the highest proportion of overall local government seats, viz. 68 per cent.

There were a number of formal and informal mechanisms which allowed, at least on paper, the representative population to be involved in the affairs of the local councils. Formal mechanisms for mass participation were included in the Local Government Ordinances. For example, in the case of taxation, every taxation proposal was published along with a notice in newspapers, so that members of the public could make their objections and suggestions. However, it was the informal channels of public participation which were, perhaps, more representative. There was, at times, a great awareness and involvement in the lives of the public of services undertaken by local councils. Expectations about the performance of local government are always high, precisely because the tasks which this level of government is expected to perform influences the lives of a large number of people at the local level. There is supposed to be frequent contact between elected councillors and their constituents, and opinions about performance are regularly aired. This was supposed to be, perhaps, the most sensitive tier of government and one in which the public was expected to be most directly involved.

Despite elaborate structures and responsibilities, it is very clear that in terms of service delivery, certainly one of the two most important pillars of decentralization and devolution in Pakistan in the form of the local government system—the other of course, being some form and some degree of political representation and participation—the local government system in Pakistan from 1979 to 1999 when it was still effectively in operation, failed significantly. Studies have shown that in terms of the skill level of local government staff and their aptitude and attitude—clearly, not a problem simply of local government but of all tiers of government in Pakistan—and due to the financial control by higher tiers by both the provincial and federal government, a problem that still continues to this day as we show below, and for a host of other reasons, *the local government structure and system failed to deliver*, even before political issues came to the fore—see below. Hence, it was not merely politics which undermined the potential and possibility of local government delivery in Pakistan, the system itself failed on technical and structural grounds.[25] However, politics did further accentuate the problem complicating matters considerably.

In their comparison of the Basic Democracies Order of 1959 and its subsequent Municipal Administrative Ordinance of 1960, with the Local Government Ordinance of 1979, Ali Cheema and Shandana Mohmand find that there 'was little change in the functions and financial powers assigned to local government. This indicates a continuity in the legislative structure of local governance and clearly shows that there was no intent during the Zia period to substantively empower local governments. The purview of these bodies continued to remain confined to the provision of essential municipal services with District Councils retaining the responsibility of rural developments. Similarly, there was little change in the financial powers given to local governments'.[26] While these similarities between both military dictators and their regimes may have existed in the structure—and perhaps even outcome—of local governments, much else, however, had changed.

The Intervention of Praetorian Politics

Three sets of Local Bodies elections were held in Pakistan in 1979, 1983 and 1987 as per the mandate of the Local Government Ordinance (LGO) 1979. There was no other representative forum for politics at that time in what is generally regarded as a particularly repressive military regime which had used the Islamic card as an excuse to prolong its rule. International factors after the Soviet invasion of Afghanistan in 1979 also helped perpetuate military rule in the form of Martial Law when numerous anti-people, especially anti-women and anti-religious minorities, laws were promulgated, and both women and minorities were the target of victimization and discrimination. The genius of the non-party elections at the local level was that they allowed existing and emerging political groups to be involved in local level issues, leaving the supposedly more important issues of the economy, foreign policy, federation, etc. in the hands of the military. Power throughout the Zia period, without a doubt, was highly centralized and rested with the military and its co-opted classes, fractions, and groups, particularly those that represented some Islamic faction and constituency and were General Zia's key partners.

However, while the military had its own favourites and carefully selected and favoured many social groups at different times, in different cities and provinces, and simultaneously persecuted the most popular political party, the Pakistan People's Party of Z. A. Bhutto later taken over by his daughter, social transformation was taking place independently, but also as a consequence of economic policies followed in this period. On the political front, it was the re-introduction of the Local Bodies elections that led to the political emergence, and possibly even consolidation, of the middle class, both urban and rural. Given the intrinsic connection between politics and economics in Pakistan, it is not surprising that each reinforced the other.

Since 'real' elections to the Provincial and National Assemblies were not held under Zia until at least 1985 (and how 'real' they were is a moot point), most of the traditional political entities did not take the first Local Bodies elections seriously. Also, because severe restrictions were imposed by General Zia's government on participation, many stalwarts were excluded. This allowed those with some financial and political means, essentially the emerging middle class, to contest elections, perhaps for the first time. They were able to enter politics because room had been created by the absence of the richer, more influential, traditional political actors. Local government seemed to work well under military dictators, and under Zia it seemed to work rather better, because of the relative importance given to this tier of government by the large developmental funds channelled through it. Urban and rural councillors were the only elected representatives of the regime, and were responsible and accountable, given their limitations, to the needs and demands of the electorate.

In 1985, General Zia's government decided to hold General Elections for the Provincial and National Assemblies on a

non-party basis. However, political parties did exist and new ones had emerged, such as the Muhajir Qaumi Movement (MQM) in Karachi, many of which had emerged as a consequence of the Local Bodies elections held earlier. While local government elections may also have been non-party elections, individuals did have party affiliations and identities which were further crystallized in the General Elections of 1985. What is interesting is that a very large number of individuals who had been trained, for the first time ever in politics, through the Local Bodies, emerged later as members of the National and Provincial Assemblies in 1985 and in subsequent elections. In 1985, of the 240 Members of the Punjab Provincial Assembly, 124 were sitting Councillors; of the eleven Metropolitan/Municipal Corporations of Punjab and Sindh, at one time or another, mayors of as many as *ten* had been either Members of the National Assembly or Members of the Provincial Assembly; in the elections held in 1993, it was estimated that more than 70 per cent of members of the Punjab and National Assemblies started their political careers from local bodies.[27] These are quite amazing statistics which reveal a very important fact which we will discuss later, that of the importance of local government as a stepping stone for higher political power. Elections were held in 1979, 1983, and 1987, which allowed the same sections of the economic middle class to emerge as members of the political classes.

The main beneficiaries of the Zia regime were, then, members of the urban and rural middle classes, and members of the civil and, particularly, military bureaucracy. The large industrialists of the Ayub era also returned to Pakistan, although the nature of the entrepreneur under Zia was considerably different from that under Ayub. Rather than 22 families dominating Pakistan, there were perhaps a few hundred or a thousand under Zia. The industrialists under Ayub may have been richer than those under Zia, but there was probably less concentration at the top under Zia than under Ayub. However, despite this emergence of the middle class and of the new entrepreneur under Zia, political power was clearly retained in the hands of the military with a subservient bureaucracy. Large landowners, too, had made a comeback under Zia, hovering around the political establishment and being allowed some room in the 1985 elections. Nevertheless, the power of the military was endorsed by the summary end to Mohammad Khan Junejo's tenure as Prime Minister in May 1988. The military, through its considerable patronage of particular political parties and individuals—the Muhajir Qaumi Movement and Nawaz Sharif, are two of the best representatives of each category—helped create classes, parties, and factions of collaborative politicians, both at the local and higher tiers of government. Much of the intervention and interference in this period created and consolidated, what some observers believe, was the 'localization and personalization of politics at the local level.'[28] The somewhat unique concept of a praetorian democracy worked rather well for many months, but once elements of the democratic forces began to impinge upon the terrain of the military, the military demonstrated that it was well in control. The period during Zia's rule marks the first real demonstration and formal consolidation of the middle classes on Pakistan's economic and political map.

As far as our analysis is concerned, the 1985 General Elections created the first major tension and contradiction between elected local government and elections at the other two higher tiers. This pattern was to re-emerge throughout the 1988–99 democratic interregnum. As we argue above, a large number of local level politicians who had become prominent in their own region or constituency at the local level, contested the 1985 elections and were propelled to provincial and national level status, as were some political parties.[29] These politicians had begun to understand and recognize the role, influence, and the importance of the local level political process, and once they were elevated to higher status, anyone filling their local level seat, was seen as a challenger and upstart who could consolidate his/her position at the local level, eventually challenging them at the higher level. In an era—and even now—where politics was the politics of patronage, there were numerous individuals and groups as candidates, competing to appropriate that power and patronage. Local government had become important and politically powerful.

Since local governments were not a central part of the Constitution, and had been merely delegated powers by the provincial governments on the behest of the latter, it is not surprising that local governments actually owed their existence and powers to the provincial governments. Provincial governments could, and did, dismiss local governments, or on the advice of the federal government. Clearly, this was a highly subjugative, dominating relationship with local government having no independence from, leave alone influence on, the provincial government, and the provincial governments did use their influence on local governments at numerous junctures. From senior appointments to requests for more resources or the permission for increasing taxes and rates, local governments were completely dependent upon their provinces. It would not be unfair to say that local governments were controlled by the provinces; even the budgets of local councils had to be approved by the provincial governments, who were entitled to make amendments and suggestions.

Prior to the 1985 General Elections, in the absence of elected assemblies, local governments were the only popularly elected bodies and thus played important political and developmentalist roles. After the election of Members and Senators of the Provincial and National Assemblies, the role of local governments was substantially marginalized. These elected representatives had taken over some functions which local governments used to perform. Specific federal and provincial level programmes which were directed at elected provincial and federal members of parliament, such as the Five Point Programme of the Junejo government (1985–88), the People's Programme of the first Benazir Bhutto government, and other such programmes, had in many ways, intervened in the evolution of proper and improved local government and encroached upon the jurisdiction of the local governments. Under the above named programmes, elected members of Provincial and National Assemblies were given funds of considerable amount which they could use for developmentalist projects, largely on their own discretion, in their political constituency. This had severely undermined

the role local governments had been playing, despite the shortcomings mentioned above, in the development of particular (local) areas and regions.

What is perhaps more intriguing is, that in the period following the 1985 elections, but more so after the death of General Zia in 1988, when a more representative, albeit controlled, democracy with political parties emerged, local government was dispensed with. With the return of democracy in Pakistan, all local governments were dissolved. In the NWFP, all local bodies were dissolved in 1991, in Sindh in 1992, and in the Punjab in August 1993. Different reasons were given as to why the provincial governments dissolved the local governments in their own provinces. In the case of the NWFP, mismanagement and corruption were cited as reasons, while the Punjab provincial government dissolved its local governments in order to ensure that national elections to be held in October 1993 were not influenced by incumbent local government officials. Thus, in the absence of democratically elected local government officials in the rural and urban areas, Town Committees, Municipal Committees, and Municipal Corporations, were all being run by Administrators who were members of either the federal or provincial public (civil) service cadre. Administrators were appointed by the provincial government and were transferred between different posts for unspecified duration of tenure. This fact that the elected principle of local bodies was put in abeyance, reflects on the attitude of elected and non-elected government officials. There seems to be an inherent conflict of interest between different tiers of government, where local governments, because they are assumed to be the most expendable, have borne the brunt.

The local government reforms launched by General Zia ul-Haq in 1979, largely to extend his rule by centralizing power in the military and allowing local level politicians to do politics, and perhaps some development as well, continued up to 1985. However, even under General Zia's own praetorian democracy, local governments floundered as many of the former councillors, mayors and chairmen graduated to the Provincial and National Assemblies. After 1988, however, when four General Elections were held in Pakistan, local governments became almost redundant, primarily because they became *competing centres of patronage and power* in contrast to elected representatives at the two higher tiers. Since the higher tiers had the power to dispense with these local governments, as argued above citing different reasons, they did exactly that. With the return of democracy in 1988, local government was made largely redundant. It had to be Pakistan's third military coup and fourth military ruler, General Musharraf who took over power in 1999, to resurrect a completely new system of devolution represented through yet another local government system under the Devolution Plan 2000 which set up District Governments.

12.1.3 Devolution in the New Millennium

An examination of three military takeovers and coups in Pakistan, in 1958, 1977, and 1999, and the earliest speeches that Generals Ayub, Zia, and Musharraf made, show an uncanny resemblance for the causes and explanations for the takeover, and the intention and programme of each General. The speeches are so similar that they could have had the same speechwriter. While corruption and inefficiency and the incompetency of politicians—always politicians—are cited as the reasons why they ousted (in the last two cases at least) democratically elected governments, each General, especially the last two, also emphasized their supposed commitment to democracy. They all said they wanted a good, accountable, and open system of democracy for the country. And, they all felt that power should be devolved to the people in some form of decentralization in the form of local government. In fact, perhaps the first substantive political intervention of all three military governments was the promulgation of ordinances that brought about three different structures of local government. In this section, we examine the Devolution Plan and the District Government system initiated in 2001, by General Musharraf.[30] Before we turn to the local government reforms, a brief description of the politics of the Musharraf regime in the context of the reforms that were undertaken is given.

The Politics of the New Millennium

The parallels between General Zia and General Musharraf's regimes, even with regard to their attempts to start devolution by setting up a local government system, are quite remarkable. Both military leaders set about bringing a local government system soon after taking power, before major world and regional events changed the nature and status of their regime permanently. General Zia started his local government reforms in 1978 and 1979 at a time when his position was weakening. However, after December 1979 when the Soviet Union invaded Afghanistan, Pakistan's status of a frontline state propelled General Zia to the world stage ensuring his longevity with American support. Almost the same scene was repeated with regard to General Musharraf's political career, although in his case, his position, because of US support, remained far stronger than General Zia's ever was. General Musharraf got to work on his local government reforms immediately after dismissing the democratically elected government of Nawaz Sharif in October 1999, at a time when his position was being questioned as the supposedly pro-democracy West castigated him for dealing a death blow to democracy, however weak it was. However, after 11 September 2001, and after the second invasion of Afghanistan, this time by the only super power in the world, General Musharraf too, was propelled not just on the world stage like General Zia, but perhaps, along with President George Bush and Prime Minister Tony Blair, as one of the most important leaders in the US War Against Terror, once again ensuring a very long political career.

Under the leadership of General Pervez Musharraf, the military reclaimed its central position in Pakistan's state structure and political scene, as it had in the past, but far more decisively and overtly. The naiveté which many of us believed throughout the 1990s that the military had removed itself from power and had allowed the democratic transition to continue unhindered—as it has in some countries—received a major shock with Pakistan's third military coup and fourth military head of government.

General Musharraf, first as Chief of Army Staff and Chief Executive of Pakistan, and then in his subsequent position, of President of Pakistan but still Chief of Army Staff, began his political interventions by beginning work on his Devolution Plan in 1999/2000. Non-party based elections were held for representatives to be elected to the new District Government setup in 2001, and the new system of local government was put in place in August 2001. A highly contentious and controversial referendum was also held in Pakistan, just as it was under General Zia ul-Haq, which gave General Musharraf the perceived right to remain President for another five years—not that any General has ever required legitimacy from any referendum, with the power of the military might determining that so called 'legitimacy'. After ensuring his own mandate and after the local government elections, General Musharraf held General Elections—again like General Zia, although this time these were party-based elections—in 2002, and set in motion the process of party-based politics after the party-less local government elections, again similar to General Zia. Hence, there existed a highly vocal and diverse representation in the Provincial and National Assemblies where members were elected on party tickets, as well as representatives at District Government, who were elected prior to this, on a party-less basis.

The Structure of District Governments[31]

The political issues related to the Musharraf regime notwithstanding, the Devolution Plan and the new system of District Government require a study on their own merit. This section does just that. The District Government structure was an integrated three-tier system, where rural and urban areas were linked together organizationally and administratively, perhaps in response to the changing demographic and locational distribution of people in Pakistan, perhaps even emphasizing the primacy of urbanizm as a way of life by removing the urban-rural divide. The system of local government ran from the Union to the Tehsil and then District level, from the smallest electoral and administrative unit to the highest.

The three-tiered structure was based on the Union/Tehsil/District levels/stages of administrative hierarchy, with the Union being the first level of contact in this structure, rising to the more important and powerful District Council. The Union Council had an elected representation with the Union *Nazim* and Union *Naib Nazim* as the heads of the Council. The Union *Nazim* was responsible for the preparation of the Annual Development Plan of the Union Council and decided the priorities and proposals with the Council. He was responsible for the execution of those projects for which funds had been provided by the Union Council budget. He was to send those proposals to the Tehsil Municipal Administration and the district government for inclusion in their budgets and development plans which were beyond the scope of the Union Council resources. The Union Council, the lowest level of elected government, had an average population of around 25,000, corresponding to several small villages or sub-villages and sub-towns in the larger settlements. Each Union Council consisted of 21 members elected on a non-party basis.

At the tehsil level, the *Naib Nazims* of all Union Councils in the Tehsil became part of the Tehsil Council, which was headed by a Tehsil *Nazim* who was the head of the Tehsil Municipal Administration. He was also expected to make an Annual Budget Development Plan for municipal services at the Tehsil level. Since this was one higher rung on the District Government tier, the structure of administration was slightly more advanced than at the simple Union Council level. The Tehsil *Nazim* headed the council and was responsible for efficient municipal service delivery and executing the development plans approved by the Tehsil Council. He was assisted by a Tehsil Municipal Officer and four other Tehsil officers. The Tehsil Council consisted of the directly elected union *Naib Nazims* and around one-third indirectly elected members such as women, minorities and peasants/workers. The Tehsil Municipal Administration which was responsible for municipal functions and spatial planning, included the offices of the Urban Local Councils established under the repealed LGO of 1979, with some sub-offices of the old system passed on to the tehsil level.

The District Council was the highest and most important entity in the new structure of district government. The system of administration at the district level included the *Zila Nazim* who had a large team of district administrators. The district administration comprised District Officers to carry out functions decentralized from previous provincial departments. Some of the offices may have represented a single department but had their group of offices headed by an Executive District Officer (EDO) at the District, such as Education or Health. Similarly other officers with related functions were grouped together under Executive District Officers. The work of the district administration was co-ordinated by a District Co-ordination Officer who reported to the elected head of government. The District Council consisted of the directly elected Union Council *Nazims* and around one-third indirectly elected members such as women, minorities and peasants/workers. Hence, the elected representatives at the lowest tier of government, the Union Council level, found themselves in the Union Council, with their *Naib Nazims* in the Tehsil Council and with the *Nazims* of the Union Councils making up the District Councils. The four provincial headquarters had been declared as City Districts and if/when a city or tehsil became urbanized and grew in size, it could be designated as a City District. In a City District, a Town Municipal Administration was organized on a pattern to the Tehsil Municipal Administration in any other district.

The major social sector departments of Education and Health were the key departments which had been devolved to the districts. Both of these departments had already undertaken some detailed planning for decentralization, prior to the devolution programme of the military government. The management of all primary and secondary schools and colleges was now the responsibility of the District Government and not of the provincial Education Department as in the past. The EDO Education, bore the major responsibility for ensuring that the educational needs of the District were adequately met; he was also responsible for planning and establishing new institutions where necessary. Amongst the duties and functions of the EDO

Education were the following: implementing the provincial education policy through the district education policy and plan; preparing plans for development of education in the district covering the levels that fall within the responsibility of the district; and preparing the annual educational budget of the district.

There had been many significant departures made from earlier models of local government under the District Government system in use in Pakistan. Firstly, a number of provincial government functions related to the delivery of social services had been devolved to the District Government. Moreover, many of the functionaries at the local level provincial administration had been transferred to the local government and were accountable to the elected district level administration. While there had been some decentralization in the sense that some provincial powers, duties, and responsibilities had been transferred to the local level, *there had been no decentralization of any federal level powers, duties, or responsibilities to either the provincial or district level.* Hence the accusation that in fact, rather than devolving power, *power had actually become centralized in the state* and its institutions, particularly in the military.

Despite the big claim made about the nature of devolution and decentralization by the Musharraf government, it is noteworthy that local government was still not part of the Constitution. Only the highly controversial 17th Amendment allowed some partial, time-bound protection to local government. One of the more important, perhaps revolutionary, interventions and changes made, however, had been the allocation of one-third seats reserved for women. Now women, in addition to contesting seats at any level directly, also had one-third seats available for them. Only three women were able to become *Nazims* in the 106 District Governments through direct elections and while there had been stiff opposition to this move in more conservative areas of the NWFP and Balochistan provinces, for the most part, there had been considerable space created for women to enter the political field. Of course, real and meaningful change takes time, but this was a very significant and positive development towards the politicization of women and bringing them in to the mainstream. Another equally important and impressive change had been the end of separate electorates for religious minorities who have once again been reintegrated into the political mainstream as well—see Box 12.1.

An important innovation with the District Government system, on paper at least, since it was not fully functional, had been the setting up of Citizen Community Boards (CCBs) in every area, where groups of non-elected citizens would work towards the development and uplift of their areas. CCBs could also raise funds through voluntary contributions, and could also receive financial support from local governments. Although most CCBs were still non-existent, there were a few cases where, for example, they had set-up shelters for schools in a district.

The District Government structure was part of the controversial Legal Framework Ordinance (LFO) which was responsible for the complete disruption of elected Parliament for more than fifteen months after the October 2002 General Elections. Subsequently, parts of the LFO became incorporated, controversially, in the 17th Amendment to the Constitution of Pakistan under which the District Government system received partial and temporary indemnity. Since, as has been the tradition in the past, all military governments establish their own form of local government first before any democracy at the higher tiers is allowed—Ayub Khan's Basic Democracies, Zia ul-Haq's Local Bodies, Pervez Musharraf's District Government—quite often democratically elected governments at higher tiers make local government redundant.

On paper then, it seems that the District Government system set up by the Musharraf military government, seemed to have some new and innovative ideas. However, whether it actually worked, both in terms of devolving political power and allowing greater participation and accountability, and in terms of its ability to be more responsive to the community's needs in terms of the better provision of public services, is partially discussed in Section 12.3. The first year of the new system had considerable teething problems, and studies which looked at that period, not surprisingly, were critical. Even after some years, however, research was still lacking and there was need to examine the system in some detail. However, as has always been the case, electoral politics at the higher tiers—provincial and national—had once again hindered the evolution of the local government system in Pakistan, and any research and study which examines the performance of local government *qua* local government, cannot ignore this imposing reality. After the 2002 elections, elected members at the provincial level, as had been the care in the past began to come into conflict with members at the district level, undermining the latter's sovereignty.

12.2 Financing Local Government

One of the two most critical factors that have an effect on the functioning of any devolved system of government, is the one related to the *politics of power* at the local level, but also at the provincial and federal levels—particularly in a country like Pakistan, where the military dominates, issues that have been continually raised and elaborated upon in the context of the discussions that has taken place in earlier sections and in other chapters in this book. Linked to the politics of power, of course, is the financing of local government for, with service delivery the second cornerstone to devolution, one cannot have a fully functioning and efficient local government system unless financial issues around it are also investigated. We argue, that while local governments have had to deal with authoritarianism and other issues at the provincial and federal level, they have also had to contend with significant financial constraints which have an impact on the performance, and hence on the failure or success, of the functioning of local government. In this Section, we describe, highlight and analyse some of the financial issues related to local government that have a bearing on its performance.

Box 12.1

Women, Democracy, and Devolution

Afiya S. Zia and S. Akbar Zaidi examine the path of devolution and local government in Pakistan, and look at how large numbers of women were accommodated under General Musharraf's District Government system.

Each of the three—not including Gen Yahya Khan—military men who ruled Pakistan—each for around a decade or so, devised his own form of devolution and decentralization reflected in different systems and manifestations of local government. The pattern from 1958 has been repeated, where the earliest intervention of a military dictator has been to devise and implement his own preferred form of local government. Once the military man was no longer in power, and especially when he was replaced with a democratic dispensation of varying sorts, his model of local government was virtually the first component of the system to be dismantled.

The incumbent PPP government that came into power in 2008 took about two years to put to rest the devolution and local government system devised by Pakistan's most recent military dictator, Gen Pervez Musharraf.

Such interventions were primarily meant to make it easier for each of the three military generals to manipulate the political order to ensure his control over the political system, often by postponing the electoral and democratic process at a provincial and national level.

However, one cannot deny the fact that eight or 10 years of a particular form of social engineering is bound to have numerous consequences, some even positive. Zia ul-Haq's 1979 Local Governance Ordinance helped more than a dozen urban and rural elected leaders to acquire passage to the highest institutions of government in Pakistan. A former Pakistani president was a chairman in a district council before he was elevated to the highest civilian position in the country. Moreover, urban political parties emerged as key players in the assemblies through Zia ul-Haq's system of local government.

The main consequence of former Gen Musharraf's devolution system has undoubtedly been the extraordinary entrance of women as elected and nominated public representatives at the lowest tier of government. With 33 per cent reserved seats for women at all levels in the devolution system, 36,066 women councillors were elected and nominated in the first round of local government elections in 2001. With the size of the councils reduced in 2005, but still with the 33 per cent reserved seats for women, 24,528 women were elected to serve the public through the local government system. In a society considered 'tribal', backward, conservative and much worse, this entry of women as public representatives must stand out as the most important outcome of the devolution reforms undertaken in Pakistan.

While cynics always point out that women in Pakistan are largely tools in the hands of their menfolk, one cannot be oblivious to the impact the public presence of thousands of women had on their, and their communities', lives.

Despite numerous flaws—in particular the absence of fiscal decentralization—in Musharraf's local government system in the eight years in which it was in place, considerable social capital at the local level in the form of collective and participatory activities, such as the citizens community boards, musalihat anjumans and other such participatory forums, was created.

Previously existing institutions and social, political and—in particular—power relations, were all challenged, changed and affected. The irony cannot be lost that in many ways the devolution process by a military dictator may have actually helped democratise—through increased representation and participation—the political involvement of citizens.

There is not only the need to endorse the symbolic worth of local governance. The pragmatic aspects too must be seriously evaluated at this critical point. Practically all districts across all provinces (though not necessarily in equal measure) demonstrated a successful and organic process that gradually drew together developmental efforts on the part of councillors, NGOs, law-enforcement personnel, provincial representatives and the people.

Not always smooth and not without political leveraging, many indicators nevertheless show that these relationships have matured into what can only be assessed as a working citizenship. By this we refer to the meetings of local actors who attempted some mutual agreement at resolving conflict, implementing schemes and surviving or developing as a community.

There are also signs that indicate that working relationships were potentially becoming more democratised and replacing traditional ones that depended on biradari systems and forced marriages. Such emerging processes may be affected adversely if not recognized as an important social change associated with devolution over this last decade.

Ours is just one view on how the local government system functioned, and there are those who differ sharply. However, the problem is that while Musharraf's local government system has been thrown out, there has been no fair assessment of its functioning or achievements.

Donors, who were central in supporting the military dictator, especially his devolution plan, have not undertaken any meaningful assessment of the millions of dollars they poured into it. They now wait for a new system to emerge, which they will also support and pay for, and all this without accounting for all that has already been spent.

Clearly, before any new system of local government is devised, there needs to be an honest appraisal of the one that it will replace, rather than a simplistic or mechanical trade-off. Even if it was created by a military dictator, democratic governments can learn much from social relationships and delivery processes of these last two terms.

Moreover, in the past, whenever elected governments replaced the local government system inherited from military dictators, they chose to do away with elected local government altogether. We recognize that the present electoral and democratic dispensation in parliament may be far more representative and democratic in many important ways than such arrangements in the past. However, the true test of how far elected representatives are willing to go to bring about and deepen democracy will come when they actually hold elections at the local level and when elected representatives are in place at all three tiers of government.

Source: Zia, Afiya S., and S. Akbar Zaidi, 'Democracy and Devolution, *Dawn*, Karachi, http://archives.dawn.com/archives/30750

Financing under the 1979 Local Government System[32]

The Federation of Pakistan continues to be governed by the Constitution of Pakistan of 1973 and all amendments in it since then, although it has been trampled upon and altered, and subjugated to the personal and political whims of the two military Generals who have held power since. The Constitution specifies the functions of the federal government and of the provincial governments. The federal government has exclusive responsibility for undertaking functions under the Federal Legislative List which is contained in the Fourth Schedule [Article 70(4)] of the 1973 Constitution—see Chapter 10 for more details.

Many of the Residual functions not part of either of the Legislative Lists which were supposed to be performed by the provincial governments had been delegated to the local governments by the promulgation of ordinances in the past, especially prior to Decentralization Plan 2000—see below. Of the functions allocated to local government in the past by the provincial governments, there were a set of *compulsory* functions which, especially urban councils, were expected to perform, in addition to an *optional* set of functions, which as the name suggests, may or may not have been performed by the local governments.

Under the old local government system and structure of the LGO 1979, the entire revenue of all local governments—rural and urban—formed a mere 5 per cent of revenue generated by the different tiers of government, with the federal government earning close to 89 per cent, and the remaining being generated by the provincial governments. Over time, the share of revenue generated by local governments had been rising, albeit marginally, while that of the provincial governments had fallen. The local governments had collectively, been able to show a better fiscal effort in terms of tax and non-tax revenue generation in the last ten years. Nevertheless, as a share of all revenues generated, the contribution of local governments was always very small.

As far as expenditure was concerned, local governments spent only about 4 per cent of the total expenditure of all forms of governments in the country, showing their relative unimportance in this regard. This relative amount fell over the last decade before the new system was put in place. As far as recurring expenditure was concerned, local governments spent a much larger share on establishment costs as ten per cent of all expenditure on general administration in the country used to be spent by local governments. Of the recurring expenditure on the social services in the country, provincial governments spent the largest share since education and health were provincial concerns. Local governments contributed ten per cent to the establishment costs of social services. Over time, the federal government shifted its contribution on the development side to the provincial and local governments, hence causing both to contribute more over the 1990s. Thus, in 1979–80, provincial governments were incurring a share in total development expenditure in the country of about 18 per cent; this rose to 29 per cent in 1985–86. Similarly, in the same period, local government increased its share from 3 per cent to about 6 per cent.

Since local governments came under the jurisdiction of provincial governments—they still do—their right to levy taxes was also subject to the directives of the latter. Local governments assist the provincial governments in the collection of revenue, and thus provincial governments had delegated the right of the collection of taxes to local governments as indicated in the Local Government Ordinance of 1979.

Local governments had been instructed to charge a local rate or local cess on all land assessable to either rent, land revenue, or ushr in their jurisdiction. The provincial government would determine the rate to be charged and could change it from time to time as it deemed fit. Local bodies were authorized by the provincial government to levy all or any of the taxes laid out in the Second Schedule of the LGO. All urban local governments on the direction of their provincial governments could levy the following taxes:

> Tax on the import of goods and animals in the jurisdiction of the Committee for consumption, use or sale therein; tax on the annual rental value of buildings and land; tax on cinemas and cinema tickets; entertainment tax on dramatical [sic.] and theatrical shows; tax on the transfer of immovable property; water rate; drainage rate; conservancy rate; tax on all kinds of vehicles; lighting rate; tax on the birth of children; fee for the erection and re-erection of buildings; marriage tax; fee for the licenses, sanctions and permits granted by the Committee; fees on the slaughter of animals; tax on professions, trade, callings and employment; market fees; tax on advertisements; tax on feasts when more than twenty persons, not belonging to the household of the persons arranging the feast, are entertained with foodstuffs; tax on animals and sale of animals; toll tax on roads, bridges and ferries maintained by the Committee; fees at fairs, agricultural shows, industrial exhibitions, tournaments and other public gatherings; fees for specific services rendered by a Committee; tax for the construction or maintenance of any work of public utility; parking fees; and any other tax which Government is empowered to levy by law.

Other than the taxes identified in the Second Schedule, provincial governments could direct any specific local council to levy any other tax; to reduce or increase any existing tax; and to suspend or abolish the levy of any existing tax. The provincial government had also given permission to the local councils and their Chairmen to make changes in the existing tax structure by drawing up specific taxation proposals. For urban councils, there was basically no variation in fiscal powers by municipal status. Also, for the most part, the taxes, rates, tolls, and fees that could be levied by Union Councils and District Councils, were very similar to those which could be levied by urban government.

The Local Government Ordinance prescribed the various sources of revenue which local governments had access to. As a whole, in urban areas taxes formed about 60 per cent of revenue, while the remainder accrued from non-tax sources.

The single largest source of revenue for urban councils was the octroi tax which accounted for in excess of 50 per cent of revenue. This was more significant for larger corporations, while the share fell as the size of the urban council decreased. This pattern was not unexpected, since this was based on goods being brought into council areas. In highly developed areas with a larger consumer base, and with areas producing industrial goods, more goods were imported and consumed, hence the higher share of the tax.

The property related taxes such, as the urban immovable property tax and the tax on the transfer of property, constituted the next largest source of revenue, and together constituted about ten per cent. Again, property related taxes yielded higher revenues in the larger cities such as metropolitan and municipal corporations. The smaller urban councils depended on non-tax receipts more than did the larger councils. Licenses, fees and other non-tax receipts constituted a far greater share in smaller towns/cities than in larger ones. The only tax levied by both urban and rural councils was the tax on transfer of property, which is levied at the time of sale on immovable property. The assessment was based on the total value of the property at the time of the transfer.

Financing under the 2001 Local Government System

The Local Government Ordinance (LGO) promulgated by provincial governments during August 2001, with amendments during 2002, assigned clear powers, responsibilities and service delivery functions to three levels of local governments: district, tehsil, and union. In effect, responsibilities for the delivery of social and human development services, such as primary and basic health, education and social welfare, now rests at the district level, whereas municipal services, such as water, sanitation and urban services, are to be delivered at the tehsil level.

The LGO 2001 made some bold changes into the earlier decentralized local government system with, perhaps, the biggest change and innovation with the case of fiscal decentralization. Fiscal decentralization requires provinces to devise transparent mechanisms to transfer revenues to local governments in the form of formula-driven block grants. Under the new system, local governments were to determine budgets and expenditures for most services, whereas only policy issues, guidelines and monitoring functions were to remain with provincial and federal governments. Higher levels of government were to provide additional, special purpose and conditional transfer to local governments as the primary means to encourage particular policy outcomes, such as poverty reduction interventions, local economic development and natural resource management.

Until the implementation of the Devolution Plan and the LGO 2001, as we show above, the system of budgeting was highly centralized and wrought with numerous serious problems. On paper at least, the new Devolution Plan made radical departures from the past. The new Plan, claimed that earlier the identification, appraisal and approval of development projects was highly centralized, with little community participation, inappropriate design and poor cost effectiveness. The new Plan tried to incorporate and address these weaknesses.

In theory, at least, the provincial departments were not supposed to determine the distribution of funds. For this purpose, a Provincial Finance Commission (PFC) was to be established by each province to develop fiscal transfer mechanisms and the formula for the distribution of funds. The Finance Commission was supposed to ensure the distribution of resources between the provincial and local governments out of the proceeds of the Provincial Consolidated Fund into a Provincial Retained Account and a Provincial Allocable Amount, which was then supposed to be distributed to the three tiers of local government in the provinces. The shares of each local government tier were to be provided on a monthly basis. The Provincial Allocable Amount and shares of the local governments were to be on the basis of monthly receipts of the government.

Each local government was expected to have a single fund, which would have included the funds received from the provincial governments, the transfer made according to the formula of the PFC, and own revenue generated by the local governments. The transfer was to take place directly from the provincial level to each local government. Since the octroi and *zila* tax, two of the most important local taxes had been done away with in the new scheme, 2.5 per cent of the General Sales Tax was to be provided to the local governments. In addition to the fiscal transfers from the provinces, the local governments had been authorised to levy a number of taxes, depending on the level and capacity of each tier of the local government structure. Local governments were given new statutory sources of revenue. They now had the independence to decide on the rates as well as the levies. Two new taxes, namely health and education taxes, had been given to the local councils—see Tables 12.1 and 12.2.

Under the new budgeting system, the *Nazim*, before the commencement of each financial year, was expected to present the budget for approval by the respective Council at each tier. The provincial governments were to inform the District Governments in March of each year, the total share including development and non-development share, expected to be available to each local government. Once they were informed of the share, each local government would need to develop its own budgets for development and non-development purposes. The development budget amount was to be the amount left over after budgeting for recurring costs and liabilities. The budget for running the Councils was to be a charged expenditure.

With regard to the non-development expenditure, which was to cater to the recurring costs of offices and service delivery, the concerned Finance and Budget official was responsible for preparing the non-development budget for the district government, which was to be prepared by function and by object. The district/city governments needed to allocate the non-establishment budget to various offices under them; the single budget now included the expenditure of the Council and development and non-development activities funded previously through the local fund.

The development budgets were to cater to the needs for new assets or for improving old ones at the local government

Table 12.1
Local Tax and Non-Tax Sources under District Governments, 2002

***Zila* Council**

1. Education tax
2. Health tax
3. Tax on vehicles other than motor vehicles
4. Any other tax authorized by the Government
5. Local rate on lands assessable to land revenue
6. Fees in respect of schools, colleges, and health facilities established or maintained by the district government
7. Fees for licences granted by the district government
8. Fees for specific services rendered by a district government
9. Collection charges for recovery of tax on behalf of the government
10. Toll on new roads, bridges, within the limits of a district, other than national and provincial highways and roads

Tehsil and Town Councils

1. Local tax on services
2. Tax on the transfer of immovable property
3. Property tax on annual rental value of buildings and lands
4. Fee on advertisement and billboards
5. Fee for fairs, agricultural shows, cattle fairs, industrial exhibitions, tournaments, and other public events
6. Fee for approval of building plans and erection and re-erection of buildings
7. Fee for licenses or permits and penalties or fines for violation of the licensing rules
8. Charges for execution and maintenance of works of public utility like lighting of public places, drainage, conservancy, and water supply
9. Fee on cinemas, dramatical, theatrical shows and tickets thereof, and other entertainment.
10. Collection charges for recovery of any tax on behalf of the Government, District Government, Union Administration or any statutory authority

Union Councils

1. Fees for licensing of professions and vocations
2. Fee on sale of animals in cattle markets
3. Market fees
4. Fees for certification of births, marriages, and deaths
5. Charges for specific services rendered by the union council
6. Rate for the remuneration of Village and Neighbourhood guards
7. Rate for the execution or maintenance of any work of public utility like lighting of public places, drainage, conservancy, and water supply

Source: Anjum, Zulqarnain Hussain, 'New Local Government System: A Step Towards Community Empowerment', *The Pakistan Development Review*, vol. 40, no. 4 Part 2 (Islamabad: PIDE, 2001), 852.

level. The new system envisaged that development funds would be available after deducting all liabilities and recurring costs. The Executive District Officer (EDO) for Finance and Planning at the local level was to be responsible for the consolidation and co-ordination of the development budget of the District Government. The Tehsil Officer for Planning was responsible for the consolidation of the development budget at the tehsil municipal level. Under the new system, a Citizen Community Board had been set up which was to play a crucial role in budgeting and planning at the district level. At least twenty-five per cent of the development funds were to be spent through these boards, while the remaining 75 per cent could be spent through the offices of the concerned local governments.

The military government proposed and began implementing the Devolution Plan 2000 in order to restructure the entire governance and development structure of the country, with the aim to empower citizens through their local governments. According to the new development planning system, every local government was required by law to undertake development within its own area. Projects were to be selected by all three levels of local government: Union Councils were required to play a pivotal role at the Union level where they identified and selected projects. The Tehsil Municipal Administration was to focus on municipal service projects like the sewerage system, drinking water, etc. while the district government focuses on social sector projects, like building schools and the provision of basic health.

The new system claimed a radical departure from the old, especially in terms of development planning, selection, and execution. While, as we argue above, in the old system, project identification and execution was managed by the federal and provincial governments. The change envisaged was that at the District/Tehsil/Union levels, project identification and selection was *supposed to be made through a collaborative and consultative process involving communities and citizens*. Table 12.3 shows how the new system of local government differed from the previous two.

Once a project had been identified, e.g. a school at the Union level, a women's college at the District level, or a Basic Health

Table 12.2
Expenditure Responsibilities of Districts, Tehsils, and Union Councils, 2002

Responsibility	District	Tehsil	Union Council
Education	Primary and secondary education, literacy	X	X
Health	Dispensaries and local hospitals	X	X
Roads	District roads	Local roads and street	Local streets
Water	X	Water supply systems	Wells and ponds
Sewers and Sanitation	X	Yes	X
Fire services	X	Yes	X
Parks and playgrounds	X	Yes	Yes
Animals	X	Slaughterhouses, fairs	Cattle pounds and grazing areas
Cultural and sport services	X	Fairs, cultural events	Libraries
Street Services	X	Street lighting, signals	Street lighting
Varia	X		Register births and deaths

Source: Charlton, Jackie et al. *Pakistan's Devolution: A Note in Support of the Development Policy Review* (Islamabad: Asian Development Bank/World Bank, 2002), 19.

Unit at the Union level, the project appraisal and approval was supposed to take place. Under the new Local Government Ordinance, the planning and development function had been decentralized to the local level. In the District Office a separate office had been created to look after the District functions, and was to perform broad economic and social planning functions at the District, and ensure that it carried out appraisals of the projects formulated by the District and submit these proposals for approval to the *Zila Nazim* and to the *Zila* Council. The Finance and Planning Group Office was required to furnish the working papers to the District consultative councils and boards and prepare a development perspective for the whole District. Once finalized by the District Government, the entire set of development projects would constitute the Annual Development Programme of the District and was to be approved by the *Zila* Council. Every Union *Nazim* was a part of the *Zila* Council and they knew which of their projects (or those of others) had been accepted or rejected. Along with the Annual Development Budget, the non-development budget was also sent to the *Zila* Council for approval. Once the *Zila* Council approved a project or the budget, then the Executive District Officer for Finance and Planning, communicated the approval to all concerned. Once finalized, the projects were ready for execution and the funds are available.

It takes some years for the amount of change required, particularly in the case of fiscal decentralization and financial reform with regard to local government, to make its presence felt. It is far easier to change the electoral college or the structure of governance systems, but fiscal issues, given the deep vested interests of all actors involved, take more time. Some studies, particularly by donors, made attempts to examine these changes. The ADB/DFID/WB multi-volume study, found some overall 'modestly optimistic trends', although still found most districts were 'hugely' dependent on transfers from higher tiers of government, and despite the budgetary provisions discussed above, found that local governments had limited autonomy in preparing their budgets. Moreover, the tax base of most District Governments remained weak and very limited, which did not allow them to raise substantial additional own-source revenues.[34]

It is important to state that ADB/DFID/WB study was an apolitical, technocratic, study which looked at managerial and fiscal issues, but specifically stayed away from political issues. This undermines the worth of any analysis, for the real issues, as we argue in this chapter, are always about *power* and are, therefore, *political*. Even fiscal issues are about power, control and politics. Time and again, we have seen that even the best designed technocratic solutions fall apart when they enter the real world of politics. Nevertheless, it is worth just highlighting the main observations from the ADB/DFID/WB study, since it did cover a large area, even though the entire framework of the study was technocratic and side-steps political issues—see Box 12.2.

The study found 'evidence of genuine change, particularly in the opportunities that citizens have gained to make their concerns heard', yet found 'the evidence of progress [in the practice of devolution] . . . scattered'. On financial control, clearly a *political* issue more than any other, the study identified problems which most people studying local government are familiar with, such as district officials having 'weak control over staff numbers', that they could not decide

Table 12.3
Comparison between the Basic Democracies System, LGO 1979, and the Devolution Plan, 2001

Dimensions	BDO, 1959	LGO, 1979	Devolution Plan, 2001
A. HIERARCHY OF LOCAL GOVERNMENT			
1. Tiers of Rural Councils	*Four Tiers* • Union Councils/Town Committees • Tehsil Council • District Council • Divisional Council	*Three Tiers* • Union Council • Tehsil Council	Four Tiers with No Rural/Urban distinction • Village Committee • Union Administration • Tehsil/Town Municipal Administration • District Council
2. Tiers of Urban Councils	*Four Tiers* • Union Committees • Municipal Committee • District Council • Divisional Council	*One Tier* • Town Committee or Municipal Committee or Municipal Corporation or Metropolitan Corporation	
B. METHOD OF SELECTION OF MEMBERS			
1. Union Councils	Election	Election	Election
2. Tehsil Councils	Ex officio: Chairman of UCs and Town Committees	Ex officio: Chairman of UCs	Ex officio: *Naib Nazim* of UAs
3. District Councils	Ex officio: Chairman of Tehsil Council; Municipal Committee; Nomination of offical Members	Election: Nomination of official Members	Ex-officio: *Nazims* of UAs
4. Municipal Committee/	Ex officio: Chairman of Union Committee; Nomination of offical Members	Election	
C. TERMS OF COUNCIL	Five Years	Four Years	Four Years
D. HEAD OF THE COUNCIL	UC - Elected TC - Assistant Commissioner of Tehsildar DC I - Deputy Commissioner DC II - Commissioner MC - Deputy Commissioner	UC - Elected TC - Elected MC - Elected	UA - Elected TMA - Elected DC - Elected
E. REPRESENTATION OF VULNERABLE GROUPS	–	Reserved seats for: • Women • Workers/Peasants • Minorities	Reserved seats for: • Women • Workers/Peasants • Minorities
F. COORDINATION WITH NATION BUILDING DEPARTMENT	Strong	Loose	Loose
G. CONTROLLING AUTHORITY	Deputy-Commissioner or Commission	Chairman and House	Chairman and House
H. FREEDOM OF ACTION OF COUNCIL	Restricted	Less Restricted	Less Restricted
I. BUDGET APPROVAL	Deputy Commissioner	Elected House	Elected House

Source: Institute of Public Policy, *Fifth Annual Report 2008: The State of the Economy-Challenges and Opportunities* (Lahore: Institute of Public Policy, BNU, 2008), 127.

Box 12.2

Fiscal Issues under Musharraf's District Government System

If districts do raise additional revenues, then to date little attempt has been made to ensure horizontal (or vertical) harmonization of taxes among various governments. Imposition of a new tax by a local government, without any corresponding levy by other similar governments, can make mobile taxed resources move out of the taxed jurisdiction to other locations. This has clear implications for business and economic activity within the taxed jurisdiction. Inevitably, this discriminates against the more backward jurisdictions, where the revenue needs are the highest, but where, due lack of infrastructure and other amenities, economic activities are already limited. In distinction to tax equalization, which argues for equal tax rates across all jurisdictions, tax harmonization suggests that local tax structures should be consistent with the economic and social conditions of each jurisdiction. This also does not rule out the possibility of an efficient and productive tax competition among various local governments, whereby a local government can enhance taxes but prevent its impact on business and economic activity by providing better living and business environment through its expenditure decisions.

In their first year, local governments employed a variety of new revenue measures to meet their expenditure needs, with no consideration given to the viability, efficiency or sustainability of these measures. For example, a tehsil in Khairpur district, decided to use its development funds to establish public real estate, which could yield a future stream of rental income for the TMA. Not only does this run counter to the government's stated objective of withdrawing from areas of private sector expertise, the experiences of other countries point to grave risks in such a mode of revenue generation. After some Union Administrations resorted to collection of tolls (and the defunct zila tax), the federal government intervened to require that local governments get any new taxes that the plan to levy vetted by the provincial finance department. While this is important for tax harmonization and coordination and for prohibiting the local governments from thwarting national and provincial policies and objectives through imprudent taxes and other fiscal measures, it potentially undermines the independence or discretion of local governments.

Overall, districts are left with little incentive to raise additional taxes, and even less incentive to raise them well. Indeed, there are overwhelming political disincentives for nazims to levy taxes. They are primarily dependent on fiscal transfers, and under these circumstances subnational governments have few incentives either for cost efficiency or to improve efforts to raise revenues. Such imbalances can be mitigated by a combination of formula-driven predictability in the intergovernmental fiscal transfers, and autonomy for provincial governments in relation to setting the tax rate and the tax base for those revenues that are assigned to them. However, thus far, the effect of the formula based transfers has been limited, as in order to provide for a smooth transition, financing of recurrent expenditures has been determined according to the principle of 'revenue adequacy', that is, to maintain service delivery at pre-devolution levels.

The 'revenue adequacy' principle worked well to prevent large-scale disruptions in service delivery at the outset of the new system, but it has also preserved the disparities within provinces that are evident in the per capita budgets before the introduction of the interim PFC awards. This probably means that, for the nazim of good intentions, 'grantsmanship', the manipulation of expenditures in order to trigger greater transfers in the future, remains a better bet than tax effort for increasing district revenues. Still, it is intended that a reallocation will gradually reflect relative need and revenue potential. There are some changes in the size of fiscal transfers, but the implication is not yet clear.

Overall, newly-appointed district and tehsil nazims will be wary of raising additional taxes. The interim PFC awards in Sindh and the Punjab do seek to create some incentives for increased revenue generation. For instance, in Sindh, districts will be given an additional allocation matching their baseline collection of certain items. However, this may have the perverse effect of motivating districts to raise taxes regardless of how well they are spent. Districts with wider tax bases and lower efficiency may gain more than those with a narrow base and higher efficiency.

In addition, the incentives remain weak for encouraging user-fees for private goods. The community is willing to pay for improvements in the delivery of services that they value. In the case of water and sanitation, for example, devolving capital expenditures from the provincial level to the district or tehsil level, accompanied by good intentions to tie them to capacity for operations and maintenance, is unlikely to be sufficient to discipline investment. Without a relationship between quality and quantity of services delivered, on the one hand, with the cost of those services, on the other, infrastructure will suffer from under-investment and problems in operations and maintenance will continue.

Source: Manning, Nick et al. *Devolution in Pakistan—Preparing for Service Delivery Improvements* (Islamabad: World Bank, 2003), 30–32.

salary budgets or dismiss surplus staff and nor could they recruit with a free hand. Importantly, the study found that 'neither district nor tehsil authorities have any autonomous power to determine pay policy'. Similarly, local officials 'must respond to program goals and priorities that they have no hand in defining', again, clearly highly political issues given Pakistan's highly centralized state. The ADB/DFID/WB study did, nevertheless, make numerous recommendations of a 'governance'/managerial/administrative nature which could improve the functioning of local government, *within limits*, but the broader issues of substantive change, as we argue below, are of a highly politicized and political nature.

12.3 Three Military Rulers and Three Local Government Systems

Research for this chapter was conducted four years after the then devolved and decentralized District Government system of General Musharraf's military regime had been in operation. At the time of research for this chapter, when local government elections were to be held in Pakistan in August/September 2005, for the second time after the promulgation of the 2001 Local Government Ordinance, not a day went by when the local press, both English and Urdu, was inundated with articles, stories, news reports, and letters which discussed either the system itself, or the ongoing electioneering campaign. There were serious analyses by scholars about the District Government system and structure as well as interviews of candidates and incumbent *Nazims*. The two themes that emerged in the discussion were based broadly on the politics related to the system and about the impact and performance of the sitting councils and their *Nazims* in terms of service delivery. In this section, we first, briefly, discuss developmental aspects of the devolution process, followed by the far more important political aspects, related to the state, participation and the military.

Given Pakistan's huge development deficit, its development 'problems' will not go away in years to come. There will always be a shortfall of targets and aspirations, the demand for services will always outstrip supply. Governments will continue to be criticized for not doing enough, and perhaps local governments more than any other tier, since the work—or lack of it—which they are supposed to do, is more visible. This makes assessment of the output/work of local government difficult, yet something that cannot be avoided. Clearly, for this reason it is not possible or fair, to make any comments on the service provision and performance of the local governments in Pakistan, especially given the fact that data may be hard to come by. However, one could make some general observations about how *one ought to* look at the performance and evaluation of local governments in Pakistan and outline future research needs.

Without a doubt, there is a need for greater monitoring and evaluation of local governments by citizens and research organizations outside of government. Perhaps some generic measure of 'best practices' needs to be drawn up against which one can assess the performance of other local governments. An institution (or long term research agenda) can monitor the performance of a selection of District Governments against a set of measurable criteria underlining achievement and failure and publicizing the results in the media, as a sort of local government watchdog. The absence of Citizens Community Boards (CCBs), a cornerstone to the District Government Plan, was a case in point. With very few CCBs existing, one already had a research and political angle to evaluating the performance of the local government system in place in Pakistan. However, such an effort would have required a group of citizens working with a research team at an institution, to follow this through. A key issue in the problems of local government has been the insufficient finances that local governments have available—as we argue above—and hence research needs should address solutions to this core problem. Another persistent problem in the quality of delivery of services from local government, was their lack of skills and training. Many District Governments did not have the capacity to do what they were expected to do, simply because they did not have the managerial or administrative capacity, areas where research could identify specific gaps. However, while these governance and financial issues are important, we feel that many of these problems had their roots in the larger politics of the land and how the state was run and how resources are controlled.

The *Dawn* newspaper from Karachi in its 1 August 2005 report, for example, gave a detailed report of a seminar held in Lahore in which technocrats, former *Nazims*, officials of the Musharraf government and a host of others, spoke.[35] The *Nazims* of Kohat in the NWFP and of Karachi, both of whom were members of political parties and groups which were not in power at the provincial level, stated that their local governments 'performed well during their first year [2001–02] in office, but started having problems after the induction of provincial governments'.[36] The Chairman of the National Reconstruction Bureau, a government think tank responsible for managing and developing the District Government system, defended the system and spoke about many of the new powers that *Nazims* had acquired through the new system, including some functions of the provincial government which had been devolved to the tier of local governments. Many of the other speakers criticized the system for its weaknesses, particularly because they felt that the provincial government had too much power over the District Governments and had ample room to interfere. Many speakers felt that the system had not really been devolved. However, from the newspaper report one gets the sense that despite the problems and criticism, there was grudging acceptance of the local government system as it then existed in practice.

In the same issue of the newspaper while there were numerous reports about the ongoing election campaign, there was also a detailed analytical article by one of Pakistan's more prominent civil society democrats who also heads the Human Rights Commission of Pakistan. The key argument that I. A. Rehman made, was that the four provincial ministers were trying to make the local governments their 'fiefdoms' and ensure that their candidates were elected. He wrote that the 'chief ministers . . . are working overtime to ensure that local government elections are won by their protégés and favourites, as if their future in office depends on this. (They may well be right)'.[37] He argued, that it was the 'central authorities' who had 'willed that the local bodies should, instead of empowering the people, become fiefdoms of the provincial chief ministers'. Rehman's article discussed the numerous amendments which had been made in the LGO 2001 for the current round of elections. He showed, for example, that further powers had been given to the provincial chief ministers to dismiss elected *Nazims*, and how the *Nazim's* powers had been curtailed through these amendments. Despite these changes, Rehman accepted that the reasons that 'the grant of unbridled powers to chief ministers over the

life and death of *Nazims* has not dampened the enthusiasm of candidates for such offices is easy to understand. If all that a *Nazim* is required to do is to keep the boss in the provincial capital happy, the office becomes more attractive, not less'.[38] One gets the feeling, that we have been here before.

The general perception in Pakistan in 2005, was that the much touted Devolution Plan of the military government was in the state of a near crisis. After the elections of the National and Provincial Assemblies, as has happened so many times in the past, the local government system imposed by the military, continued to be questioned by the elected members of the higher tiers of government. These elected Provincial and National Assembly members felt that the system of District Government had taken away some of their control and privileges and so they felt threatened. Hence, as in the past, a contradiction between the politics of democracy—even a praetorian democracy—and the politics of the military re-emerged. To make matters worse and to undermine the local government system established by the military government, elected representatives at the National Assembly level had all been promised large sums of money for developmental purposes which they were supposed to spend in their constituency, throwing into peril the carefully crafted local government fiscal and development model. Even donors, otherwise the most vociferous supporters of Musharraf and all his policies, particularly that of devolution, conceded that 'the opportunism of national and provincial assembly politics has resulted in further competition between MPAs [Members of the Provincial Assembly] and local councillors for control over assets through which they can manage their constituency relations'.[39]

Lest it be misunderstood that these examples are either infrequent or very recent, related only to the electioneering phase and the public debate, some examples from the past will only help highlight some of the many issues that exist around the process and system of local government in Pakistan. In March 2004, the International Crisis Group (ICG) launched its *Devolution in Pakistan* Report and stated:

> While the ostensible aim of Musharraf's devolution scheme may be the transfer of administrative, political and financial authority to the lowers tiers of government, the reality is starkly different. Local governments in fact exercise only nominal autonomy with respect to administrative and financial matters in their respective jurisdictions.[40]

The Report adds, that:

> 'Local governments have proved to be the key instruments in the military's manipulation of the Pakistani polity to ensure regime survival. District nazims used public funds and other state resources to stage pro-Musharraf rallies during the April 2002 presidential referendum and to support the Pakistan Muslim League (Quiaid-e-Azam) parliamentary candidates in the 2002 national polls. Local governments have also had significant utility for the military's divide-and-rule tactics. By juxtaposing more than 100 new local governments between it and the provinces, the centre, where the military continues to maintain its grip on the levers of state power, has been strengthened at the cost of Pakistan's four federating units.
>
> 'If Pakistan's chequered political history is any barometer, the question of devolution cannot be addressed in isolation from the larger issue of provincial autonomy . . . Pakistan's civil-military ruling elite . . . has often used the administrative and coercive powers at its disposal to extend the centre's control over the provinces. Since military-inspired devolution is directed to local levels, it enhances tensions between the centre and the provinces.'[41]

The ICG Report believed that 'the military's political engineering that accompanies it [local government reform] is widening divisions at the local and provincial levels. Some of these could well lead to greater domestic violence and instability'.[42] Clearly, in terms of the politics of local government reform under the military, we see that the story in Pakistan was repeated for the third time under its third military coup maker which created Pakistan's third devolved and decentralized local government system. History, it seems, had repeated itself, not just the first time as tragedy, but the second time, as farce. Both the previous local government systems which were seen to be the cornerstone of both military governments, even after being in place for a decade or so, fell apart with the fall of the regime with which they were so closely associated.

A second round of elections for the District Government were held and numerous innovations were made in the second tenure of these governments between 2005–09. However, with the fall of the Musharraf regime and with the end of the tenure of the elected District Governments, the People's Party government and its allies, decided to do away with the Musharraf model of decentralization and devolution, and even after five years of being in power, were unwilling to propose a structure or model which would replace the previous system. Clearly, history did repeat itself, once again.

Moreover, what is interesting and instructive, is to compare the role which local government played in 2005 when the earthquake struck Pakistan and when elected local governments existed, compared to 2010 and 2011, when floods hit Pakistan in the absence of elected local government. While there are some problems in making a direct comparison between the floods and the earthquake, the absence of elected local governments at the time of the floods made relief and rehabilitation difficult. In the 2005 earthquake relief and rehabilitation process, elected local government officials played a critical role.

Also worth pointing out is, that after the 18th Amendment to the Constitution when many powers from the federal government had been devolved to the provincial government, as it ought to have happened, local government responsibilities and decisions about the nature of local government, such as what type of system they want or when elections are to be held, are now the responsibility only of the provincial government. A failure of local government and the inability

to hold elections at the local government level is clearly a failure of the four provincial governments. One cannot hold the federal government responsible for delaying elections at the local government level any longer—see Appendix 12.1 for a post-Musharraf evaluation of his district government system.

12.4 Is Local Government the Answer?[43]

12.4.1 The Contribution of Municipal Government in Development

The overall analysis of municipal, i.e. urban, local governments regarding the provision of services in the old system prior to 2000, suggests a number of conclusions. Firstly, almost all councils in the larger urban centres more or less restricted their role exclusively to the performance of some (or all) compulsory functions. In smaller towns and cities, the financial and institutional capabilities of the councils restricted even the performance of compulsory functions, leave alone those of an optional nature as well. In these cases, the provincial government intervened to help these governments make ends meet—both financially and technically. In larger cities, water and sewerage authorities and development agencies played a critical ancillary role to the municipal governments. Without this assistance, it is unlikely that local governments, even in big cities, could have managed. Some of the optional functions of these governments were also performed by such specialized agencies.[44]

Even though education and health were the primary responsibility of the provincial governments, both sectors continued to play an extremely important role in the provision of services in cities. In larger cities, the provincial government played a minimal role, as a large number of schools and medical facilities were either private or had been developed, administered, and financed by the local municipal government. However, even large cities such as Peshawar (pop. 1.5 million), lacked the capability to run and develop their own schools, hospitals, and dispensaries.[45] In smaller towns, the provincial governments played a formidable role, not only in education and health, but in almost all other sectors as well. The reason for this is clear, that smaller urban centres lacked technical and administrative capabilities and did not have adequate staff to undertake substantial development works. In many cases, large schemes (water supply, sanitation, drainage) which can only be undertaken by the provincial department in the case of smaller towns and cities were, after completion, handed over to the local council. The local council was then responsible for operation and maintenance costs, which many were unable to meet.[46]

Essentially, then, local municipal governments, given the structure at that time, especially that which came with a smaller size, did not have the capability to provide essential services which could have had positive effects on development in terms of water supply, drainage and sanitation, primary education, and hospitals and dispensaries. While many governments lacked technical capabilities, financial constraints were even more severe.

A very large share of municipal government expenditure was recurring expenditure, a trend which was more pronounced in large cities. This expenditure went towards maintaining and operating water supply schemes, public health, education, and curative care. The highest per capita expenditure in the urban councils of the two biggest provinces, Sindh and Punjab, was incurred on roads. In Balochistan and the NWFP it was on drainage. In urban areas in the country, the high-priority sectors for development were water supply, sewerage and drainage, and roads, collectively accounting for 50 per cent of development expenditure.[47]

The picture regarding development provided and undertaken by municipal governments in the past, is therefore particularly dismal. Urban local governments, with the possible exception of the larger metropolitan corporations in Karachi and Lahore, along with a handful of the bigger cities, did not provide either services or facilities which would have a positive developmental effect. As we have argued in much of this chapter, while there has been some change in design and structure under the new district government scheme, the *generic* problems remain the same as those in the past.

12.4.2 Potential for Development by Local Governments

Urban local governments were specified a large and varied number of tasks and functions which they had to perform, and some which they may themselves have chosen to perform. The scope of the statutes regarding the provision of services and facilities was broad enough to encourage major projects in the social sector which could have benefitted underprivileged and vulnerable groups, especially women and children. Almost all major areas were covered in the statutes and very few more could have been added. Technically, provincial governments could delegate further responsibilities to the local governments as they deem fit.

The problem, then, was not one of statutory limitations, but financial and technical, and possibly conceptual and motivational, constraints to developing facilities affecting social welfare for the general public. There is a clear relationship with size of city as far as the possibilities are concerned. The larger cities (or, as we argue now, the larger, richer districts) are usually in a position to raise funds and provide facilities and services for their population. Smaller towns, cities and districts just do not have the resources—of any kind—to provide other than the very basic facilities, such as roads and drainage. To expect anything else would be very unrealistic. However, even the relatively large Peshawar Municipal Corporation in the past, spent as much as 86 per cent of its budget on salaries and on electricity bills.[48] While Lahore Metropolitan Corporation did have a large number of health and medical facilities, it spent in all less than one-half of a per cent on health care, or ten paisa per inhabitant.[49] Thus, while the larger corporations did have access to more funds, their budgets, too, were quite small. The low fiscal outlay of the Municipal Councils necessarily made the salary and administrative costs look excessive. Thus, where revenue

and expenditure were limited, as was the case in almost all councils, the costs of administration remained high, and will continue to be so, until the time when the municipal revenue base is restructured and substantially enhanced.

While financial constraints were the biggest hindrance to the provision of services and facilities in cities, there were some others as well. In the larger cities, the establishment of development authorities and of specialized organizations like the water and sanitation agencies under the provincial government played an important role in delivering services.[50] In small cities, the provision of local infrastructure was usually carried out by provincial line departments, in particular the Public Health and Engineering Department, in the case of water supply and sanitation. This meant that local bodies had been left in the role of having to provide for solid waste management, cleansing services, drains, etc. This implied that while services and facilities were provided to the inhabitants, local governments had their role further marginalized. It was relegated to that of operating and maintaining services which were developed and created by other agencies, a role that they were reluctant to play as they felt they were not involved in the planning and implementation process at an earlier stage. Furthermore, the link between service provision and local taxation had been weakened, and hence local government resource provision had been less than its potential.

The provision of services and facilities by other agencies had meant that local governments were not willing or eager to develop their own organizational and technical capability. It has been seen that many communities are willing to pay local taxes and user charges if they feel that adequate services will be delivered. However, local bodies will have little incentive to generate additional sources of income if they are not in a position or under compulsion to provide municipal services because such provision is under the control of other agencies. Thus, on the one hand, while specialist agencies did provide facilities, their presence undermined the role that local governments should have played.[51]

An overview of municipal local government reveals that even basic services and facilities were not provided by local governments because they did not have the funds to do so. Furthermore, even if there was expenditure on sanitation, water, etc. there was no guarantee that the projects envisaged by local governments would deliver to the more needy segment of the population. In most cities, it is the well-to-do who have access to better facilities. Poorer neighbourhoods, often on unregularized lands, where the most vulnerable and underprivileged people live, do not have access to the most basic of facilities. The population which needs facilities most for its development is often neglected the most by all tiers of government.

12.4.3 Is Local Government the Answer?

While there has recently been growing lip-service paid to the role that local governments in any guise, including that of the district governments, are expected to play in development, it seems quite clear that the existing structure of government in Pakistan does still not permit any meaningful role to this important tier in the hierarchy. Local government with the exception of a few large city district governments has been reduced to an institution that pays recurring costs incurred by schemes often developed by other levels of government. Furthermore, most, if not all, local governments face severe financial constraints and are not even in a position to pay the salaries of their employees.

In the early 1980s, local governments seemed set to play a productive role in development, but ironically, the return to democracy at the national and provincial levels helped to subvert that possibility. Today, local government in Pakistan is the least likely, given existing administrative and financial structures, to be able to play any positive role in development. Unless substantial steps are taken to redefine the context and nature of local development, local government will continue to be ineffective.

Even under General Pervez Musharraf's Devolution Plan under which District Governments had been created and put in place, the basic *contradiction* between higher tiers—particularly provincial—emerged again. See Box 12.3 on the problems with local government.

It would also be fair to say that local governments are not solely responsible for the dire straits they are in. Unless provincial and national governments practise better governance at all levels of the hierarchical structure, the status quo is unlikely to be changed. Local governments are ineffective not so much due to their own faults, but due to the way they have been treated by the higher echelons of government. For local governments to work more effectively, higher tiers of government must have more confidence in them and must relinquish effective control. Any meaningful desire for devolution and decentralization must incorporate the practice of devolving power and resources from the federal level to the provincial first, before an effective local government under the provincial government can work productively. After the 18th Amendment, the onus is on the provincial governments to develop their own local governments.[52]

12.5 Summary and Further Reading

12.5.1 Summary

This chapter explores broadly the decentralization and devolution debate and experience in Pakistan in a political economy framework and context, with emphasis on contextualizing power and examining issues of devolution and decentralization within a wider framework and context of state-society relations. The main contribution of this chapter is that it follows a political economy approach and framework which requires a broader, more holistic view, and distances itself from a purely administrative/managerial/governance related evaluation, which have become the norm for international donor organizations.

There have been three substantive interventions in the decentralization and devolution process and structure in Pakistan since 1947, manifest through different administrative structures of local government. All the three attempts at local government reform in the form of decentralization and

Appendix 12.1

Democracy, Military Rule, and Local Government

This selection of articles from various issues of the *The News on Sunday*, over the last few years after the fall of the Musharraf regime and after the rehabilitation of democracy in Pakistan in 2008, highlights many of the issues which emerged with regard to the local government system imposed by the fourth military government. It shows how there was wide disagreement on whether the system should be done away with or whether it should be replaced by that of another military dictator. By September 2013, there were no elected local governments in Pakistan and there was little agreement in the four provinces about which system suited them.

I.

Sikander Ali Hullio writes:

The dream project of military regimes—in the name of ensuring real democracy and empowering grassroots communities, the three-tier local government structure in Pakistan, is once again in hot waters and courting controversy in the wake of equal demands being made either for drastic amendments or a complete repealing by major political forces that emerged out of the general elections held early this year.

Midwifed with much fanfare respectively by General Ayub, Zia ul-Haq, and Pervez Musharraf, this pet project of successive dictatorial regimes has never been fully owned as envisioned by the major political forces in the country over the past five decades, except partial ownership in the seventies and late eighties. It merely outlined an agenda to implement under the title, New Social Contract by Benazir Bhutto, in early nineties.

The existing three-tier local governance was born out of the much talked about seven-point reforms agenda announced by Pervez Musharraf after his Oct. 1999 takeover of power. It was formally launched on 14 August 2001, after selective countrywide consultations and deliberations made by the National Reconstruction Bureau (NRB), created for the reconstruction of institutions, then headed by Lt Gen (r) Tanvir Naqvi who is widely believed to be the father of the existing system.

Later, Daniyal Aziz effectively managed the reforms agenda, but it started to lose strength with the weakening of the Musharraf regime early last year.

Instead of piloting in some districts, as initially suggested to General Naqvi at that time by a panel of top governance consultants working with the NRB, the local governance system was launched uniformly across the country on non-party basis for a four-year term, having 23 members in every Union Council, which subsequently formed Tehsil and District councils. In its first tenure (2001–2005), the total strength of elected members was around 140,000, which was reduced to nearly 80,000 in the second tenure (2005–2009) as the number of councilors was slashed from 23 to 13 due to over-representation.

Currently operational in 117 districts including 4 City Districts, 358 Tehsils, 62 Towns in City Districts, and 6,139 Union Councils, the legal basis for local governments is laid through two constitutional provisions under Articles 32 and 140-A of the Constitution. Moreover, the system is run through Local Government Ordinances which were promulgated by provincial governments respectively on 14 August 2001. The Ordinances have been included in the Sixth Schedule of the 1973 Constitution for a period of six years. These ordinances can only be amended with the previous sanction of the President after consultations with the Prime Minister in accordance with the provisions of Article 268(2) of the Constitution.

In contrast to the originally envisaged plan, the autonomous face of the district governments started dithering and was defaced thanks to drastic amendments in 2005 where, besides several structural changes, the power to dismiss and suspend was given into the hands of the chief ministers instead of the councils that served as their electoral college.

Resultantly, sandwiched between the original NRB plan and the reasserted authority of the chief ministers, the autonomy of district governments was compromised in the 2005 amendments. This whetted the appetite of the conservative for power accumulation at the provincial level. This appetite is going to destroy the very essence of the system, leaving it at the mercy of the provincial governments which are going to take over as temporarily the constitutional protection lapses next August with the completion of four years second tenure of local governance in Pakistan.

Another major structural change introduced last month is the revival of the abolished structure of Divisions. Upon abolition, there were twenty-six divisions in country, five in Sindh, six in Balochistan, seven in North-West Frontier Province, and eight in Punjab. Seven years ago, the widely believed sun which set on the 19th century colonial style of governance with the introduction of devolution plan and abolishing of the archaic system of commissioners including deputy and additional ones, is going to rise again in the country. In Punjab, the commissioners have been restored after amending the Land Revenue Act, 1967, instead of the widely expected Local Government Ordinance 2001.

Since its introduction seven years ago, several hurdles have hampered the smooth functioning of this system. Blue-eyed bureaucracy emerged on the top, in a bid to have an upper hand in terms of authority over the elected representatives. Academically, in a paternalistic elitist approach, which is based on the notion that people are not equipped to know best what is good for them, bureaucracy has always been ditching such efforts at empowering the people. This gave birth to rampant transfers and postings of officers across the country, leading to misperceptions about the local governance and its very implementation.

Politically, the system was orphaned due to its essentially non-political nature and application. The major political parties landed their B-teams of close relatives in a bid to counter and contest the elections dominated by the pro-Musharaf forces. Besides, indirect election at District and Tehsil/Town level lowered the chances of emergence of in-house leadership, as in most cases a person with big political contacts and financial resources

landed important tiers. A direct election for the top slots would have worked better in terms of efficacy and ownership.

The Union Council, a grassroots organ of the local government, has suffered neglect, although it provides key Electoral College to both upper tiers, Union Nazim (District Council) and Union Niab Nazim (Tehsil/Town Council). The entry and issuance of birth and death certificates were its prominent jobs, while skipping the assistance and supervision of District and Tehsil/Town functions and activities were undertaken at the Union level through Union Monitoring Committees. Most of the functions, sanitation, sewerage, which are being looked after at the upper level, should have been decentralized at the Union level. Moreover, it should have been given more financial autonomy.

The system envisages broad but loose monitoring mechanism through the formation of Monitoring Committees of elected members to assist and oversee each devolved department, which mostly remained intact for the sake of operational requirements but remained ineffective and reduntant. This produced a poor auditing system, leaving room for massive corruption as alleged and unearthed in the case of the TMAs auditing conducted by the Government of Punjab last month.

Moreover, several institutional mechanisms remained either in papers or were a remote possibility during the process, which could have played a highly effective role in institutionalising the system. The formation and activation of Local Government Commissions in each province, including the activation of Mohtasib (Ombudsman) office in each district, could oversee, integrate and orchestrate the local goverment functioning effectively. Similarly, Musalihat Anjumans for the conflict resolution would also have worked better if formed and activated across the country.

In contrast, the citizens' participation and engagements through Citizen Community Boards (CCBs) have reportedly shown impressive results wherever formed and activated as per the local needs.

Largely, the critics of this system have said that the devolution of power makes the district police and the civil administration subservient to the elected local councils but the plan could not touch Pakistan's social and cultural peculiarities. With the installation of the local governments, the partial power was devolved to the locally elected representatives including decentralization of administrative and financial authority to local governments and the rest was robbed off during the process, which means that the less turned into reality and still much needed to be transformed, if genuinely the system is pushed ahead with a wider ownership in times to come.

Source: Hullio, Sikander Ali, 'A Structural Analysis of Pakistan's Local Government System', *The News on Sunday*, Karachi, 23 November 2008.

II.

Adnan Adil argues:

Keeping the tradition of undoing things implemented by its predecessors, the government has allowed the 2001 local government system to expire on 31 December 2009, and according to news reports the provincial governments are set to revive the 1979 local bodies with municipal corporations in urban areas and district councils in rural areas.

Instead of making amendments in the present system to increase its accountability and service delivery, the provincial governments seem to have chosen a setup that could work as a mere appendage to the provincial authority thus depriving the common people whatever little representation and participation they had got in 2001.

To put the whole issue in perspective we take up the relevant questions one by one:

How do the local bodies work in Pakistan?
Legally speaking, local governments are an administrative arrangement of the provincial governments as they lack constitutional cover. Constitution recognizes only two tiers of governance—provincial and federal with chapters on them but there is no chapter on local governments. However, in principle, the retention of local government system is necessary to meet the requirements of Article 37(i) of the constitution, that is; state's obligation to decentralize the administration.

Lack of constitutional protection for these institutions has led to the frequent disruption of the local bodies and gave the provincial governments leeway not to hold local body elections regularly. For example, the Pakistan People's Party (PPP) governments never held local body elections in its two previous tenures in the 1970–77 and 1993–96.

Political significance of the local governments
In Pakistan, local governments, besides trade and student unions, have been the nurseries for grooming political cadre and provided the middle class people an opportunity to participate in the political process.

Representatives initially elected to the local councils rose to the national and provincial assemblies. Ayub Khan's much-maligned basic democracy system threw up on the national scene politicians that filled the rank and file of the Pakistan People's Party. Gen Zia ul-Haq's local bodies raised another generation of politicians which today makes up the most of both factions of the Pakistan Muslim League. Prime Minister Yousaf Raza Gilani himself is a product of the local body system.

For the middle classes, the local government system is the only avenue to participate in governance as the national politics is dominated either by the traditional landlord gentry or lately the moneyed urban class. A middle class person cannot think of applying for a major political party's ticket for a national or provincial assembly seat, let alone bear the election expenses. Owing to wider participation, people's participation in the past local elections has been very high as compared to the national and provincial elections.

How was the 2001 system different from the 1979 order?
The 2001 local government system was quite radical as it broke the 150-year long stranglehold of bureaucracy on the country's power system. For the first time, it brought the police and the administration, though partly, under local governance. District governments were entrusted powers to deal with 13 subjects on the provincial list, which meant that people in a far flung district did not need to travel to the provincial capitals for issues related to say education,

health, etc. The local governments became a governance unit instead of a municipal administrative unit of the provincial government as had been the practice in the past.

The 2001 system gave to the common citizen at the grassroots, particularly marginalized groups such as women, minorities, and labour, increased representation and a share in public affairs and it provided women a very direct stake in local governance.

Tehsil municipal administration, previously limited to urban areas, was extended to rural areas as a result of which the rural population started benefiting from municipal facilities, including water supply, streetlights, etc. Under the 2001 system, a local service was created in the districts while earlier most officials in the district government used to come from the provincial cadre or superior services.

Was the 2001 system fully implemented?
No. As bureaucracy and police loathed subservience to the elected representatives, the bureaucracy resisted its implementation from day one. It did not allow the system to be fully implemented. Neither village councils, nor citizen boards and police committees were formed. Central and provincial public safety commissions were not formed to oversee the functioning of police for a long time, and when the institutions belatedly came into existence, they did not function. In 2005, the provincial governments made amendments in the 2001 system to reduce the powers of local mayors and bring them under their control.

A major dishonesty was committed by retaining the huge supervisory bureaucratic structure at the provincial level when the same functions were devolved to the districts in at least 13 departments. As a result, additional government officials were recruited in the districts side by side with the provincial cadre. Instead of making the administration lean, the 2001 system was made to create additional bureaucracy and burden the national kitty. The dual control of 13 departments by the provincial and the local governments cost billions of rupees to the taxpayers.

Why opposition to the 2001 system?
The leadership of political parties, bureaucracy, and nationalists in smaller provinces are three sworn enemies of the local governments. The powers exercised by the local representatives cut through the powers and political influence of the bureaucracy and the members of the national and provincial assemblies.

The opponents of the local governments present the kind of arguments that were put forth by the colonialists opposing the transfer of power to colonies, that is; the local people are incapable of managing the system. This is the kind of argument that proponents of the strong centre use in opposing greater provincial autonomy, and in turn the nationalist parties seeking provincial autonomy use to oppose the devolution of power to the districts.

In fact, provincial elected governments prefer dealing with public servants rather than elected representatives because public servants can be transferred, while an elected district nazim can only be removed through a vote of no-confidence, which may not always be possible. The authority of the local governments in managing 13 provincial subjects is loathed by MPs as they think they want to (mis)use this authority to perpetuate their influence at the local level.

The bureaucracy had never accepted the 2001 local government system that had taken away powers enjoyed by the bureaucrats earlier. It demolished the epitome of bureaucratic power, the office of the deputy commissioner, which in popular parlance used to be known as 'king of the district' (*zila ka badshah*). Above all, the District Management Group and the police loathed subservience to local elected people, whether they come from local governments or provincial or national.

Political parties and the bureaucracy cloak their vested interests under the arguments that local governments led to massive corruption and bad law and order management. The fact is poor law and order is incorrectly cited as a failure of the local governments because they had little control over police. Law and order remained a provincial matter and district *nazims* only had minimal powers to oversee police performance.

Was there any flaw in the 2001 system?
As resistance to devolution started from day one, the authority was not fully decentralized to the district and tehsil level. A hotchpotch was made by delegating some authority to districts in 13 provincial subjects while retaining the provincial control at the same time. In effect, control of the local government system was at the district level but it was made dependent on the service, cadre and implementation machinery of the provincial government.

Under the 2001 system, local councils did not have any development funds, because they had minimal direct taxation powers. When the principal source for local government funding, the octroi tax, was given to the federal government in the form of the general sales tax (GST), their income sources were restricted to municipal corporations' assets in bigger cities. It is estimated that 80 per cent of the amount that local councils got from the federal government on account of GST collection was spent on salaries and overheads.

A major negative impact of the 2001 system was that it consolidated the hold of big landlords at the local level. In the absence of land reforms, the authority delegated to the district governments came into the hands of politically influential landlords at the district level. As the election of mayors (district nazims and tehsil nazims) was indirectly made by the directly elected representatives at the Union Council level, the feudal elements prevailed. Thus, the 2001 system strengthened local elites at the expense of national political parties. Moreover, industrialists and landlords got elected from seats reserved for workers and peasants. Women lacked authority despite increased participation.

Despite these flaws, the 2001 system transferred authority, though partly, from bureaucracy to the elected people, increased the participation of the disadvantaged groups and created a capacity at the local level to run the administration. This was a step towards decentralization and devolution, laying a foundation on which further improvements could be made.

What does the 2001 system rollback imply?
The provincial governments are yet to make legislation on the new local system. However, reports suggest that while the local councils will remain, their nature will change and they are likely to become a municipal administrative unit to exercise municipal functions at best. The abolition of the 2001 system means the supervisory role granted to districts in 13 departments will be abolished or reduced to make it minimal or just ceremonial. In other words, the local councils will be reduced to sanitation-related work alone and there would be no political or governance aspect to them.

News reports suggest under the revised system the provincial governments are relying more on bureaucracy. They have already restored the divisional tier of the administration that was scrapped in 2001 and the reinstatement of deputy commissioners and district magistrates is also on the cards. Thus, the separation of power of the judiciary from the executive achieved after a three-decade struggle would be reversed.

The 2001 local government system entailed massive amendments in dozens of laws governing the administration. Significant changes were made in the 1861 Police Act to incorporate district mayors' supervision of police though they did not have effective powers on police. To roll back the entire system, changes will be required in dozens of laws which involve district *nazims*. These wholesale amendments in laws, especially Police Order 2002 and the CRPC, etc. will require coordinated efforts by the provincial governments and the federal government as many laws fall in the purview of the federation.

As local cadre of services was created at the district level to run the administration of 13 devolved departments, this may be abolished. If it is retained to avoid political backlash, an additional bureaucracy will burden the local bodies having meagre resources. One option could be that the local government employees are merged into the provincial cadre. In most likelihood, the bureaucracy will make the government pull back all the devolved authority at the provincial level but retain the existing posts at the local and provincial levels as they provide larger scope of promotions and career opportunities. Bureaucracy wins all!

Source: Adil, Adnan, 'Back to 1979?', *The News on Sunday*, Karachi, 10 January 2010.

III.

Aoun Sahi makes the following arguments:

Many mainstream political parties—including PML-N, ANP, and some quarters of PPP (provincial governments of both Sindh and Balochistan)—are pressing to bring about changes in the local government system introduced by General Pervez Musharraf in 2001 through the Local Government Ordinance (LGO). Punjab government headed by PML-N is the first to show reservation for the local government system. It proposes the suspension of the system and appointment of non-political administrators in place of tehsil and district *nazims*.

But it seems the federal government is still not clear about the future of the system: President Asif Ali Zardari is waiting to be advised by Prime Minister Yusuf Raza Gilani and also for a report from the Ministry of Law before he makes the final decision. Reportedly, on 19 July 2009, the PM advised the president to allow the provinces to amend the Local Government (LG) laws, hence permitting them to dissolve the system and appoint administrators in place of district *nazims* until fresh LG elections.

It must be pointed out here that the local government system is protected under the Sixth Schedule of the Constitution until December 2009. The tenure of the present local government will expire on 17 October 2009. The power to take a decision on the LG will automatically go to the provinces on 1 January 2010, that will be free to amend the system in accordance with their choices, without the federal government's approval. But provincial governments are not willing to let this system function for the next four months.

Punjab Law Minister Rana Sanaullah tells TNS that there is a consensus among the four provinces over the fate of the LG—'The provinces have agree to appoint administrators in place of *nazims*. They also agree that the next LG elections will be held within a year.'

According to him, the local government system, introduced by a dictator, has become a symbol of corruption and political nepotism. 'The current shape of the system is not practicable and requires drastic amendments. In fact, we want to benefit from the 1979 local bodies system,' he says. Meanwhile, the Ministry of Law has promised to send the recommendations of the provinces to the president before 7 August 2009—'so that the provinces can make amendments in their respective laws before 14 August (i.e. to dissolve the LG and appoint administrators). For the time being there is no progress on the issue,' he confirms.

On the contrary, Muhammad Afzal Sindhu, Minister of State for Law and Justice, says: 'No time frame has been given for the submission of the report to the president. The ministry is yet to decide on the appointment of the administrators to replace the *nazims*. All provinces are onboard, but it is yet to be decided what will be the future course of action,' he tells TNS.

However, district *nazims* and local governments' representatives have adopted a different stance. The focal person of the Association of District *Nazims* in Punjab, Major (retired) Tahir Sadiq, says the democratically elected government's decision to bulldoze a representative institution with a massive public mandate justified the acts of military dictators in the past. We see no difference between what happened on 12 October 1999 and now. Abolishment of LG will weaken the federation. The demands of new provinces will become justified. They should empower the LG representatives instead of sacking them in a dictatorial manner.

He further says that section 140(A) of the constitution clearly states that power can only be transferred to the elected institutions. 'Punjab government has already approved a budget of Rs. 84.5 million for new commissioners and other bureaucrats who will be replacing the district nazims.' He adds that both PPP and PML-N had agreed under Article 10 of the Charter of Democracy that the local government would be autonomous.

He states that for the past two years the Punjab government has been accusing the local government of corruption but has not been able to prove it—not even against a single *nazim*. 'There are some reservations about audit reports in some districts but this does not make the whole system corrupt,' he says.

Some PPP sources disclose that President Asif Zardari is not in favour of the appointment of non-political administrators; instead he awaits the schedule for the next local government elections. 'PPP will not favour the appointment of non-political administrators for at least another year.'

In Sindh, however, the MQM is strongly resisting the move and has challenged Chief Minister Qaim Ali Shah's order to ban the sale, purchase, and lease of land by the district government of Karachi. The issue remains unresolved despite a series of meetings by a recently-constituted committee comprising members of PPP and MQM.

MQM's reluctance to endorse the abolition of the existing system of local governance has made it difficult for the PPP's Sindh leadership to implement the proposed appointment of administrators, says Haider Abbas Rizvi, MQM MNA.

According to him, there are many who accuse the local government of corruption and nepotism. 'But MQM has delivered while remaining within the system. Karachi's nazim was declared the top three mayors of the world.'

He does not believe that MQM is favouring the system because it will help the party to strengthen its hold in Karachi. 'We have been demanding the government to hold elections as soon as possible, at least in those provinces where law and order situation is under control,' he adds.

Salman Abid, political commentator and Regional Director Strengthening Participatory Organization (SPO), says it is understandable why PML-N is so keen to abolish the system—'because the party puts more trust in bureaucracy than in public representatives. A corrupt system is a mere excuse. The proposed amendments in the ordinance as recommended by PML-N will change the complexion of the system totally.'

The PML-N proposed amendments include regaining the control of 12 departments devolved under 2001 ordinance while the number of councillor has also been reduced to 9 from 13. The party also proposes suspension of citizen community boards with the main focus on indirect election. Only 9 councillors would be elected through direct election while the rest through indirect elections. More significantly, PML-N proposes non-party elections of local governments for the next term.

The focus, asserts Abid, should be on making the current system more effective, and most political parties had decided to not disturb the political institutions under the Charter of Democracy. 'The problem is that in Pakistan every elected representative from councillor to president wants his/her control on the development budget, so the powerful prevail, for good or bad, for democracy or not,' he concludes.

Source: Sahi, Aoun, 'Three Tiers for Democracy', *The News on Sunday*, Karachi, 30 August 2009.

IV.

Naila Inayat examines the issue of women and local government.

I am zealously watching the TV footage of former president Clinton's visit to India. I see him sitting among a group of village women from Rajasthan, discussing democracy and power. The women are all elected representatives of the panchayats. Running a dairy cooperative, they initiated loan schemes for poor, landless women in their area.

I still remember I was simply floored by the confidence these women exuded as they discussed the lack of jobs and other issues with the then president of the world's superpower. And I wondered if we would ever get to see something like that in Pakistan where, for years, women's political participation has been confined to being voters or campaigners for male candidates. Very few have been elected as public representatives on general seats at any level—federal, provincial, or local.

In the subcontinent, since 1935, a special legal provision has existed for women's reserved seats in legislative bodies. The Devolution of Power Plan 2000 has been a key development in the history of governance. Musharraf's government in March 2000 launched decentralization under the Local Government Ordinance (LGO) whereby 33 per cent quota for women at the District, Tehsil and Union council levels was adopted.

The question arose as to how could women use this critical mass to affect public policy, particularly policies like gender issues, poverty, education and mainstream themselves in the political arena. Today, almost eight years later, we have examples of many exuberant women councillors who have found themselves through the LG system and are indebted to it. Here are a few of them sharing their thoughts with TNS.

Shamim Qaiser, Dictrict Councillor from Peshawar, says, 'I remember, in 2001 when the local government election schedule was announced, Aurat Foundation aired a radio programme from Gilgit asking, 'Will any women contest the elections?' I went on air and said that the system would get an overwhelming response because women wanted to be heard. Many people were skeptical about the 33 per cent quota being 'wasted' but the reception was good indeed.

'Women got an opportunity to come out of their homes and work for the welfare of the people at large. In 2001, I was elected from Shaheen Town and for four years you should come and see how many developmental projects I initiated. From making roads to installing tube wells and laying sewerage lines I have worked on a variety of things—something that you wouldn't generally expect from a woman.

'Like all new systems even 2001's LG system has loopholes, such as the allocation of funds for women councillors. We faced a lot of problems in claiming our share in the pie; we had to fight for it and a lot of times come out victorious. However, it doesn't give anyone the right to wrap up the entire system; necessary amendments should be made and more power should be given to the people's representatives.'

Shamim Mumtaz, City Councillor from Karachi, says, 'I won the election from UC 10, Sardar Town, on the Labour seat. Honestly speaking, no one in my family has ever ventured into politics; I am the first one. But my family was very supportive and encouraged me to work for the good of the people. I have been a social activist and have worked on issues of health, unemployment, education, etc. I know that in order to be heard you have to be part of the decision-making process and the LG system is there for this very purpose.

'I am not the only one who has benefited from the system; I know women who have come up from rural Sindh. I'm sure in those under developed areas it would be much harder compared to urban areas.

'Initially, it was very difficult for me to voice my opinion in the assembly. But after attending training sessions and workshops with the private NGOs I gained a lot of confidence. This system has given us a platform to voice our views. Though there still are women who are hesitant to become part of participatory politics. Trust me, it is nothing short of a small revolution.'

Farzana Mumtaz, Programme Coordinator, Advocacy and Networking South Asia Partnership-Pakistan says, 'It was for the first time in the country's history that a mass of almost 40,000 women councillors were seen in any form of governance or decision making.'

She believes that it opened up not only an enormous political space but also a strategic opportunity for women to join in and make a difference in setting and implementing people's agenda. 'However, now the PPP led-government wants to bring back the 1979 LG system which at least will not benefit the women, the minorities and the labourers. Most women councillors want the 2001 Local Government Ordinance to be amended. How can they impose administrators on the masses?'

Source: Inayat, Naila, 'A Legal Provision', *The News on Sunday*, Karachi, 30 August 2009.

V.

Zulfiqar Shah examines how the Musharraf District Government system benfitted some parties, and how others felt excluded.

As the local government completes its second tenure in October this year, several controversies have already surfaced that question the merits and demerits of the system. Ideally, the local government should be followed by elections and, eventually, the coming into power of the next set of elected representatives. However, the current situation is such that the entire system seems to be at stake, as those for it and those against the system are pitched against each other.

PML-Q and MQM, the two biggest beneficiaries of the Musharraf policies including those regarding the local government system, are going all out to save the system which, they believe, has served the masses well at the local level whereas it works for them.

On the other hand, PML-N and PPP believe that the system was introduced to marginalize mainstream politics. They want massive changes or else a wrap-up of the system.

Within these controversies, hardly any one is looking seriously into details of the benefits this system has or even the losses it entails.

Those who were a part of the system have mixed views on the merits and demerits of the devolution system and they find it hard to tell whether it was beneficial.

In view of Munazza Hashmi, a high court lawyer and member of district council in Multan, the system has brought in representation at the grass roots level which is 'a very positive thing'. However, she adds, little or no power rests with those who came up through the grass roots.

'There were elected representatives but they had no power,' says Munazza. 'The local government ordinance was not clear; power rested only with the nazim, reducing the other members of the union council to just nominal heads.'

The LG system as outlined in the local government ordinance of 2001 provides 33 per cent representation to women, 5 per cent to peasants and labour and one seat to minorities in each union council (UC). Experts on the devolution plan think that the local government system provided a large space to middle and lower class citizens who otherwise remained outside (local) power corridors. 'The space created by the representation of women, labour and minority representatives is important,' says Salman Abid, Regional Manager, Strengthening Participatory Organization (SPO), and an expert on local government system. 'You can see a lot of movement by these groups; even the recent resistance against scrapping of the local government system is proof that people got space because of the system.'

Obviously, the system is not free of flaws and needs due attention and attempts to address them. For instance, there is a general perception that the system was not implemented in the way it was perceived or propagated and there was no devolution of power at all.

However, the debate generated in recent months on whether the system should continue or not makes one thing clear that there is a popular demand for devolution of power. Political statements, speeches in seminars organized by civil society organizations as well as discussions with the PPP leadership suggest that there is a need to devolve power. There can be differences on whether it should continue to be as the Musharraf model or remodeled. Salman says the demand is also the result of the two tenures the system has seen.

The local government system has also devolved 12 departments from provincial level to district levels and brought them under district level control. Confusion around legal issues related to this plan and also a tussle between provincial departments and district governments made this devolution difficult and on many occasions the nazims and provincial ministers went against each other publicly.

The local government ordinance is blamed for most of the problems attributed to the system as it does not clarify power sharing and also the devolution of departments.

'Entire power rests with *nazims* without any checks and balances,' says Munazza. 'You get elected, but have no powers. This creates problems for you at the local level.'

She does not agree that increase in the women's representation made any big difference.

Along with 25 other members she says she submitted a proposal for lady health park to be built in Multan, but it was never approved. 'We were 43 female members and supported the proposal, but 150 male members vetoed it.'

Despite these setbacks, she says all the women members have played their role in bringing local governance on track in the district. 'We pointed out and talked about it frankly in the council wherever we saw problems,' she adds.

There are other people who believe the system has many good, in-built spaces for village-level development programmes, but such CCBs were manipulated by *nazims* and district coordination officers. Full authority to nazims with no control of provincial and line departments had also leveled a lot of corruption allegations as allotment of contacts and use of funds remain a *nazim's* prerogative. The councils were supposed to be taken into confidence but they weren't.

Source: Shah, Zulfiqar, 'Level of Politics', *The News on Sunday*, Karachi, 30 August 2009.

NOTES

1. Much of this chapter was first written in 2005, as part of the Swiss National Science Foundation and the Swiss Directorate for Development and Cooperation (SDC) funded Project: *Swiss National Centre of Excellence in North-South Research Partnerships (NCCR-North-South)*. The chapter was written under the supervision of Dr Urs Geiser, In-charge Pakistan Programme, Development Study Group, Department of Geography, Zurich University; the Development Study Group is a member of the consortium of six Swiss research organizations which were involved in this Study. I am very grateful for detailed comments by Dr Urs Geiser. Developments since 2005 have been added to update to the present.
2. For the most part, in the context of Pakistan, much of the literature uses devolution and decentralization interchangeably and both terms are almost exclusively used with regard to local government. The subtle nuances and differences between devolution, decentralization and deconcentration are usually ignored.
3. Amongst the studies which look at post-1999 measures, see: Asian Development Bank/Department for International Development/World Bank, *Devolution in Pakistan*, in three volumes (Islamabad, 2004), (hereinafter referred to as the ADB/DFID/WB study); Nick Manning et al. *Devolution in Pakistan: Preparing for Service Delivery* (Islamabad: World Bank, 2003); Jackie Charlton, et al. *Pakistan Devolution: A Note in Support of the Development Policy Review, mimeo* (Islamabad: 2002); National Reconstruction Bureau, Government of Pakistan, *The Local Government Book* (Islamabad, 2002); Zulqarnain H Anjum, 'New Local Government System: A Step Towards Community Empowerment', *Pakistan Development Review*, vol. 40 no. 4, 2001; Aisha Ghaus-Pasha, and Hafiz Pasha, 'Devolution and Fiscal Decentralization', *Pakistan Development Review*, vol. 39 no. 4, 2000; National Reconstruction Bureau, Government of Pakistan, *Local Government Plan* (Islamabad, 2000).
4. See the work of Ali Cheema, Asim Ijaz Khwaja and Adnan Qadir, 'Local Government Reform in Pakistan: Context, Content and Causes', in P. Bardhan and D. Mookherjee (eds.), *Decentralization and Local Governance in Developing Countries: A Comparative Perspective* (Massachusetts: MIT Press, 2006); Ali Cheema. and Shandana Mohmand, 'The Political Economy of Devolved Provision: Equity-based Targeting or Elite Capture—Case Evidence from Two Pakistani Unions', unpublished mimeo (Lahore: Lahore University of Management Sciences, 2005); Ali Cheema. and Shandana Mohmand, 'Provisional Responses to Devolved Service Delivery—Case Evidence from Jaranwala Tehsil', mimeo (Lahore: Lahore University of Management Sciences, 2004); Ali Cheema. and Shandana Mohmand, 'Local Government Reforms in Pakistan: Legitimizing Centralization or a Driver for Pro-Poor Change?' unpublished mimeo, 2003.
5. See: Foqia Khan, 'Capitalist Transformation, State, Social Groups and Law; A Case Study of Pakistan', unpublished mimeo, January 2004; Ali Cheema, 'State and Capital in Pakistan: The Changing Politics of Accumulation', in A M Reed, *Corporate Capitalism in Contemporary South Asia: Conventional Wisdoms and South Asian Realities (London:* Palgrave, 2003); Reza Ali, 'Underestimating Urbanization?', in S Akbar Zaidi, (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003); Arif Hasan, *The Unplanned Revolution* (Karachi: City Press, 2002); Mohammad Qadeer, 'Ruralopolises: The Spatial Organization and Residential Land Economy of High-density Rural Regions in South Asia', *Urban Studies*, Vol. 37, No. 9, 2000; Mohammad Qadeer, 'Urbanization of Everybody: Institutional Imperatives and Social Transformation in Pakistan', Paper presented at the 15th Annual General Meeting and Conference of the Pakistan Society of Development Economists, November 1999; Andrew Wilder, *The Pakistani Voter: Electoral Politics and Voting Behaviour in the Punjab* (Karachi: Oxford University Press, 1999). Other references can be found in in Chapters 26 and 27.
6. For further details and for insight on the reforms in this period, see: Douglas E. Ashford, *National Development and Local Reform: Political Participation in Morocco, Tunisia, and Pakistan* (Princeton: Princeton University Press, 1967); Najmul Abedin, *Local Administration and Politics in Modernising Societies: Bangladesh and Pakistan* (Dhaka: National Institute of Public Administration, 1973); and S. Shahid Ali Rizvi, *Local Government in Pakistan: A Study in Clash of Ideas* (Karachi: Centre for Research in Local Government, University of Karachi, 1980).
7. Ashford, op. cit., 94.
8. Ibid. 96.
9. Ibid. 96.
10. Rizvi, op. cit., 32.
11. Ibid. 42.
12. Ali Cheema et al. op. cit., forthcoming.
13. Ibid. 6.
14. H. J. Friedman, 'Pakistan's Experiment in Basic Democracies', *Pacific Affairs*, vol. 33, June 1960, cited in Ibid.
15. Interestingly, following the first few months after the takeover by General Musharraf in October 1999, there was talk about building a new local government system, rumours were rife that the new system would be similar to General Ayub's and would be used as an Electoral College for General Musharraf.
16. Parts of this section are drawn from different chapters in this book.
17. Shahid Javed Burki, *Pakistan: A Nation in the Making* (Boulder, Colorado:: Westview Press, 1986), 112.
18. Ibid. 54.
19. Rizvi, op. cit., 228.
20. Cited in Ibid., 229.
21. Cheema and Mohmand, op. cit., 2003.
22. A very large number of studies examining the local government system during the 1977–88 period (which, as we show, continued well into the 1990s) have been conducted, many of them looking at fiscal and financial issues in the 1990s when the debt and deficit crisis had reached unmanageable heights. Perhaps what is more interesting is that most of the studies that have been undertaken, deal almost exclusively with urban (municipal) reform rather than issues related to local government in general. It is not at all possible to give even a representative list, but for a small sampling of studies see: M. A. Z. Wajidi, *Local Government in Pakistan: A Case Study of Karachi 1842–1988* (Karachi: Royal Book Company, 2000); S. Akbar Zaidi,

'Politics, Institution, Poverty: The Case of Karachi', *Economic and Political Weekly*, vol. 32, no. 51, 1997; S. Akbar Zaidi, 'Urban Local Government in Pakistan', *Economic and Political Weekly*, vol. 31, no. 44, 1996; Applied Economics Research Centre, *Resource Mobilization by Provincial and Local Government in Pakistan* (Karachi: AERC, 1992); Applied Economics Research Centre, *Resource Mobilization and Institutional Capacity Study*, (in seven volumes) (Karachi: AERC, 1991); Applied Economics Research Centre, *Local Government Finances and Administration in Pakistan*, (in three volumes) (Karachi: AERC, 1990); Applied Economics Research Centre, *A Model of Municipal Finance in Pakistan* (Karachi: AERC, 1990). In addition, the extensive research work by Arif Hasan and Reza Ali, looking at urban, and hence municipal, issues, also need to be read for a better understanding of local government developments throughout the 1980s and 1990s.

23. Cheema and Mohmand, op. cit., 2003.
24. For the local government system in Karachi, and particularly for its political manifestation, see: S. Akbar Zaidi, op. cit., 1997.
25. See the references cited in Footnote 22, as well as S. Akbar Zaidi, 'The Role of Municipalities in Infrastructure: Some Evidence from Small and Intermediate Towns in Sindh', in S. Akbar Zaidi, *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999).
26. Cheema and Mohmand, op. cit., 2003.
27. See *The News* on Friday, Special Report on Local Bodies, 30 September 1994.
28. Ali Cheema et al. op. cit., forthcoming.
29. For example, Fakhr Imam, the Speaker of the National Assembly emerged on the national scene starting his political career at the local level in Faisalabad, as did Farooq Leghari who came from the district level elections in Dera Ghazi Khan to eventually become President of Pakistan; the Mayors of Karachi and Lahore too, emerged as national level leaders once they were elected in the general elections. There are numerous other such examples.
30. Over a period of many months, elections were held under General Musharraf's Devolution Plan in 2000 and 2001 and all 106 District Governments were in place by August 2001. At the time of writing, August 2005, District Governments had completed their four year tenure and stood dissolved with the election process underway to elect new local government representatives.
31. This Section is drawn from a number of sources, in particular: Ali Cheema et al. forthcoming; N. Manning et al. op. cit., 2003; Ali Cheema, and Shandana Mohmand, op. cit., 2003; National Reconstruction Bureau, op. cit., 2002; and Z. Anjum, op. cit., 2001.
32. See many of the references cited in Note 22.
33. Although we are talking about the financial issues related to the 1979 LGO, it is important to say that many of the mechanisms of broad financial and budgeting are of a more generic nature and these problems and even the mechanisms, continue to exist.
34. See ADB/DFID/WB, op. cit., 2004.
35. *Dawn*, Karachi, 1 August 2005.
36. Since the 2001 District Government elections were held on a non-party basis, supposedly independent candidates were elected. In the 2002 party-based General Elections at the provincial and national level, political parties formed governments. Whenever the provincial government, particularly in the case of Sindh and the NWFP but in other provinces as well, came into conflict with a Nazim not of the ruling party in government in the province, the provincial governments made life very difficult for the Nazim, curtailing their mandate considerably, even starting summary proceedings against them on various occasions.
37. I. A. Rehman, 'Local Bodies: Whose Fiefdom?', *Dawn*, Karachi, 1 August 2005.
38. Ibid.
39. Asian Development Bank, *Decentralization Support Programme: Progress Report* (Manila: ADB, December 2004).
40. Cited in Nadeem Iqbal, 'Devolution Questioned', *The News on Sunday*, Karachi, 11 April 2004.
41. Ibid.
42 Ibid.
43. This section is a summarized extract from the paper by Zaidi, S. Akbar, 'Urban Local Government in Pakistan', op. cit., 1996; See also Zaidi, S. Akbar, op. cit., 1997(a); Zaidi, S. Akbar, op. cit., 1997(b); and Zaidi, S. Akbar, op. cit., 1999.
44. See AERC, op. cit., 1990; AERC, op. cit., 1993; Zaidi, S. Akbar, 'Effective Local Level Delivery of Human Resources: Development Related Programmes—the Case of Pakistan', mimeo (Bangkok: UNESCAP, 1991); Zaidi, S. Akbar, 'A Study on Making Optimal Use of Municipal Budgets to Finance Child Development (Pakistan)', mimeo (Karachi: UNICEF, 1994); Zaidi, S. Akbar, op. cit., 1996; Zaidi, S. Akbar, op. cit., 1997(a); Zaidi, S. Akbar, op. cit., 1997(b); Zaidi, S. Akbar, op. cit., 1999.
45. Zaidi, S. Akbar, op. cit., 1994; Zaidi, S. Akbar, op. cit., 1996; and Zaidi, S. Akbar, op. cit., 1997(a).
46. AERC, op. cit., 1991; AERC, op. cit., 1993; Zaidi, S. Akbar, op. cit., 1994; Zaidi, S. Akbar, op. cit., 1996; Zaidi, S. Akbar, op. cit., 1997(a); Zaidi, S. Akbar, op. cit., 1997(b); and Zaidi, S. Akbar, op. cit., 1999.
47. AERC, op. cit., 1990; AERC, op. cit., 1991.
48. Zaidi, S. Akbar, op. cit., 1994.
49. Ibid.
50. AERC, op. cit., 1993; Zaidi, S. Akbar, op. cit., 1996; Zaidi, S. Akbar, op. cit., 1997(a); Zaidi, S, Akbar, op. cit., 1997(b); and Zaidi, S. Akbar, op. cit., 1999.
51. AERC, op. cit., 1991; AERC, op. cit., 1992(a); AERC, op. cit., 1993; Zaidi, S. Akbar, op. cit., 1996; and Zaidi, S. Akbar, op. cit., 1997(a).
52. See Zaidi, S. Akbar, op. cit., 1996; Zaidi, S. Akbar, op. cit., 1997(a); Zaidi, S. Akbar, op. cit., 1997(b); Zaidi, S. Akbar, 'Karachi: Prospects for the Future', in Khuhro, Hameeda (ed.), *Karachi: Megacity of Our Times* (Karachi: Oxford University Press, 1997); Zaidi, S. Akbar, op. cit., 1999(c).

13 Fiscal Federalism in Pakistan: Emerging Dynamics, Issues, and Prospects[1]

Much has changed in Pakistan, at least on paper and in constitutional terms, in the way the government is to function and finances are to be allocated, after the passage of the Seventh National Finance Commission (NFC) Award,[2] and especially after the passing of the 18th Amendment to the Constitution of Pakistan,[3] in 2010. The earlier structures of finance, expenditure, relationship of the federating units with the federation, and other aspects of how Pakistan's government was required to be administered, changed quite radically as a result of these two landmark legislative actions, which were moreover adopted unanimously at the provincial and the federal level. Many of the earlier structures, as we showed in Chapters 10 and 12, are now redundant, and the provinces have been given far more responsibility for social sector development—see Part VII of this book. Although it has been three years since the passing of both, the 7th NFC Award and the 18th Amendment, the full consequences have not yet been realized nor have they become manifest in the way governments function in Pakistan. Moreover, the academic as well as political debates about the consequences of both have only just begun and there is limited literature which examines the possible outcomes of either or both. This chapter is one of the first to be written on these issues, and explores possibilities, and potential and possible consequences.

It is believed that these significant changes will transform the dynamics of the vertical structures of governance in a more rational direction and create horizontal equalization by strengthening decentralization and facilitating devolution of the power structure. Unlike the developments in Indian fiscal federalism after the 7th Indian Finance Commission (1979–1984) and compared to other developing countries, the process of systematic scientific rationalization of fiscal federalism had not taken place in Pakistan in the past. Consequently, increasing regional disparities created a sense of insecurity and injustice amongst deprived provinces. Noor- ul-Islam[4] argued that apart from other disturbing factors, fiscal disparities were the major concerns that led to the fall of East Pakistan. Apart from the linguistic movement of Bengali nationalism, military operation, and infringement of civil rights, there were constantly increasing inter-regional fiscal inequalities and disparities in the distribution of national resources which aggravated the sense of grievances and resulted in the Six Point formula of the Awami League, and spurred the separatist movement.

13.1 Pre-Independence Evolution and Development

The present evolution of federalism in Pakistan has a long history from the colonial rule of the British Empire to four different military regimes of thirty-three years, and various democratic governments. The three important legislative developments in British India were the Government of India Act 1885, the Government of India Act 1919, and the Government of India Act, 1935.

The Government of India Act, 1885: The Act is part of legislative developments under British rule. It developed a governance structure under Crown rule. Both the authority and the governance structure were predominantly of a centralized nature under this Act. The Secretary of State to India was given enormous judicial, financial, and functional powers with immediate delegation to the Viceroy/Governor General. For the purpose of the resolution of local territorial disputes, the judicial powers were delegated to the princely states. The relations with princely states, communications, and military were controlled by the centre.

The Government of India Act, 1919: During the period of the First World War, British rule undertook reforms in the subcontinent. The Montagu-Chelmsford proposal regarding political, administrative, and financial reforms were made part of the India Act of 1919. One of the fiscal developments was the assignment of irrigation and land revenue, forestry, and judicial stamp duties to the provinces, and the exercise of authority by the provinces was legitimized through this Act.

The Government of India Act, 1935: Analysing its political developments the Act approved a bicameral political system with a legislature consisting of two chambers, i.e. a Council of State and a Federal Assembly. The Council of State was a permanent body with one-third of its members being elected after every three years, while the duration of the Federal Assembly was fixed for five years. On account of fiscal developments, revenues, and expenditures, assignments were explicitly defined with a Federal Legislative List and a Concurrent List (the functions of which were the joint responsibility of both the centre and provinces). Details of revenue assignment and sharing under this Act were as follows:

1) Taxes were assigned exclusively to the centre, e.g. import duties, revenue of railways, posts, and telegraph. 2) Taxes assigned to the provinces e.g. agriculture tax, sales tax, land revenue irrigation charges, property tax on agriculture, tolls, payroll taxes, excises, and levy on natural resources.

3) Taxes imposed by the centre but having revenue sharing arrangements with the provinces, e.g. export duties from jute, export duties and income taxes except agriculture tax.
4) Taxes levied by the central government but distributed and allocated among the provincial governments, i.e. stamp duties, succession duties, freight earnings.

13.1.1 The Otto Niemeyer Award 1936[5]

On 19 September 1935, the British Government announced an enquiry into how and when to announce provincial autonomy in India which had been demanded for some years. The mandate of the enquiry was as follows:

> The need for inquiry arises from the fact that although the main outlines of the system of Federal finance have been established by the Act, it provides that the allocation of certain resources between the Central and the Provincial Governments of India shall be settled by Order-in-Council after the British Government has been furnished with an independent review of the position of the Provinces and the centre and with the technical advice that the financial questions involve.[6]

The final recommendations were submitted in 1936 and reported in the press as:

> His Majesty's Government may safely propose to Parliament that Part Three of the Government of India Act should be brought into operation a year hence. He has formed the opinion that the budgetary prospects of India, provided that there is prudent management of her finances, justify the view that adequate assignments can be made by steps to meet the financial implications of the new Constitution. In the detailed proposals submitted, the paramount importance, upon which the report insists, of preserving the stability of the central finances has been kept carefully in mind.[7]

The Otto Niemeyer Award recommended a vertical 50:50 revenue sharing arrangement between the centre and provinces. Under this Award and the 1935 Act, agriculture tax was primarily a provincial subject and not part of the divisible pool. Sales tax was also a provincial subject and was part of the central divisible pool. In addition, Sindh and NWFP were provided with annual fixed subvention of Rs.10 and Rs.10.5 million, respectively.

13.1.2 Post-Independence Evolution and Developments—NFC Awards in Retrospect

At the time of independence, the Government of India Act of 1935 remained in place as a provisional constitutional instrument pending Pakistan framing its own constitution. In the absence of regulatory institutions and banking networks the Reserve Bank of India continued its operation on both sides of the border, right up to the inauguration of the State Bank of Pakistan on 1 July 1948 under the Governorship of Zahid Hussain. Members of the Indian civil services of British India who migrated to Pakistan were assigned charge of important positions. Unfortunately, the quest for a new constitution for Pakistan diminished after the death of the first Governor General M. A. Jinnah on 11 September 1948 and the assassination of Liaquat Ali Khan on 17 October 1951. Later, on 28 May 1955, in pursuance of the Governor General's Order No. 12 of 1955, the second Constituent Assembly was instituted. The Assembly consisted of 80 members, 40 from each of the wings, East and West Pakistan. In 1956 this Constituent Assembly enacted the first Constitution of Pakistan.

Realistically speaking, during Pakistan's infancy, its national politics became part of a power game between the civil bureaucracy and the military establishment. Six governments were changed during a short span of seven years.

The dismal state of affairs brought radical institutional decay which continued over time. The ratification of the dismissal of the Constituent Assembly by the Governor General Ghulam Muhammad in the Maulvi Tamizuddin vs the Federation of Pakistan case by the higher judiciary advocating the principle of *Salus Populi suprema lux est* —'the good of the people is supreme law' set out a precedent for the abrogation of the Constitution in the future. Justice A. R. Cornelius was the only judge in the case to write a dissenting note in this landmark decision. This judgment altogether changed the course of politics in Pakistan. History continually witnessed such coups legitimized by the courts setting out the direction of Pakistan's destiny. The differences and conflict of interest between institutions and the overall dominance of the military over civilian government affairs, made it difficult for Pakistan to build its state institutions.

Fiscal administration and policy is not an exception, and the National Finance Commission has recorded a history of ad-hocism and a lack of scientific approach. We now discuss the individual NFC Awards as a historical narrative and their merits and demerits in detail in the following section.

13.2 The National Finance Commission Award: An Introduction

The public finance structure of Pakistan has been significantly dependant on intergovernmental fiscal transfers, i.e. transfers of public resources between various levels of government, federal, provincial, and local. This section is based on a historical narrative of the evolution of the intergovernmental fiscal transfers system and it focuses on transfers between federal and provincial governments. The transfers to the local tier of government are presently administered and governed through the Provincial Finance Commission, i.e. transfers of funds from provinces to local districts governments. Presently the federating units under the constitutional mandate of the National Finance Commission are the four provinces of Pakistan, i.e. Punjab, Sindh, Khyber Pakhtunkhwa (formerly

the North West Frontier Province NWFP), and Balochistan. The Federally Administered Tribal Areas (FATA), although part of the federation are not covered under the formal arrangement of the federal transfer system; however, a system of special grants is in place and functional for FATA.[8]

As per clause (1) of Article 160 of the Constitution of Pakistan 1973, the President of Pakistan shall constitute a National Finance Commission with a formal structure consisting of Federal Minister of Finance and four provincial finance ministers and non-statutory members (other persons) as may be appointed by the President after consultations with Governors of the provinces.

The primary responsibility of the members of the National Finance Commission is to advise the President on the distribution of resources from the divisible pool. After the separation of East Pakistan, the divisible pool transfers have been distributed on the sole basis of the population criterion. The 18th Amendment to the 1973 Constitution of Pakistan, added clause 3(A) and 3(B) to Article 160, where Article 3(A) gives protection to the province and specifies that the share of the province in each Award of the National Finance Commission shall not be less than the share allocated to the Province in the preceding Award. Clause 3(B) is related to the provision of good governance which has now become an important feature of the Commission's stipulation. The clause designates the Federal Minister Finance and provincial Finance Ministers to monitor and administer the implementation of the Award, and to present their reports biannually before both houses of Parliament and the Provincial Assemblies.

Apart from divisible pool transfers, under the article 163 of the Constitution, the NFC recognizes the rights of provinces on indigenous resources which are transferred by the federal government to the provinces directly as straight transfers.

The system of intergovernmental fiscal transfers by the federal government to the provinces, generally provides two types of fiscal transfers: 1) unconditional and 2) conditional transfers. The extent of unconditional transfers had predominantly greater weightage as compared to the conditional transfers in the overall intergovernmental fiscal transfers in Pakistan.

Unconditional Transfers

Divisible Pool Transfers

These transfers are vertical sharing arrangements between the federation and the provinces and after the NFC 2010, the size of the divisible pool available for the provinces has considerably increased. This is how greater financial autonomy is ensured. Further, the horizontal distribution criteria of the 7th NFC Award, 2010, provide for multiple indicators, i.e. population, poverty and backwardness, revenue collection and generation, and inverse population density. All of the Awards preceding the present one distributed revenues on the sole criterion of population. The Award-wise analysis of the post-1971 divisible pool transfers in Pakistan is shown in Table 13.1. On average, Punjab receives relatively smaller amounts on account of the divisible pool transfers as compared to its share in the total population, and the case of the rest of the provinces is more or less the converse. The divisible pool transfers had a neutral effect on fiscal equalization up to the NFC 1991 and 1997 Awards, and no equalization in the NFC 2006 Award. However, structural shifts to multiple criteria caused the transfers to be more equalizing which can be a policy objective of multiple criteria, although there are some inherent problems with this Award. Provinces have been given higher vertical shares and encumbered with high functional assignments after the 18th Amendment.

Straight Transfers

As shown in Table 13.2, Balochistan dominated initially on account of straight transfers and this supremacy continued until 1991, after which the share of Balochistan started declining. More recently, Sindh has benefitted by gaining a higher share in straight transfers. The question of fiscal equalization does not arise here because the right of provinces on these resources has been established, however, these transfers are fiscally administered by the federal government. Below we empirically discuss straight transfers in the context of fiscal equalization (*the Concentration Index*) in detail, and compute the concentration index to analyse the direction and beneficiaries of these transfers.

Special Grants

Fiscal equalization is the objective for successful administration of intergovernmental fiscal relations. Balochistan and Khyber Pakhtunkhwa are the provinces far behind Punjab and Sindh in terms of human development, health, and education indicators and growth rate in per capita income (see Tables 13.15, 13.16, 13.17, 13.18 and 13.19). Keeping in view the relative position of Balochistan and KPK, both are

Table 13.1
Average Divisible Pool Transfers during Various NFC Awards

NFC Awards	Punjab	Sindh	KPK	Balochistan
1973–1975	56.08	24.08	15.39	4.44
1976–1979	59.90	22.98	13.28	3.83
1980–1983	60.23	22.52	13.38	3.86
1984–1991	57.97	23.34	13.39	5.30
1992–1997	57.75	23.46	13.51	5.29
1998–2006	57.50	23.33	13.60	5.57
2007–2010	55.85	24.30	14.26	5.59
2011–2014	50.70	24.06	16.06	9.19
Average	57.13	23.43	13.93	5.52
Maxima	60.23	24.30	16.06	9.19
Minima	50.70	22.52	13.28	3.83

Source: Ratios are computed on the basis of Revised Estimates of the Federal Budget Explanatory Memorandum on Federal Receipts various issues. All percentages are computed on revised figures except 2013–14 *(budgeted)*

Table 13.2
Average Straight Transfers during Various NFC Awards

NFC Awards	Punjab	Sindh	KPK	Balochistan
1973–1975	6.40	–	–	93.60
1976–1979	8.27	3.97	–	87.77
1980–1983	4.39	13.48	–	82.13
1984–1991	4.56	24.04	–	71.40
1992–1997	8.20	27.68	34.65	29.46
1998–2006	11.86	45.35	20.38	22.42
2007–2010	11.21	62.45	10.57	15.78
2011–2014	8.04	59.50	19.52	12.95
Average	8.08	33.78	21.28	45.99
Maxima	11.86	62.45	34.65	93.60
Minima	4.39	3.97	10.57	12.95

Source: Ratios are computed on the basis of Revised Estimates of the Federal Budget Explanatory Memorandum on Federal Receipts various issues. All percentages are computed on revised figures except 2013–14 (budgeted)

Table 13.3
Average Non-Development Grants during Various NFC Awards

NFC Awards	Punjab	Sindh	KPK	Balochistan
1973–75	36.65	9.150	25.62	28.58
1976–79	25.25	10.03	41.68	23.05
1980–83	11.11	10.30	58.12	20.47
1984–91	36.08	20.91	32.45	10.56
1992–97	26.60	48.37	5.320	19.71
1998–06	25.30	21.76	22.77	30.17
2007–10	39.69	29.98	18.58	11.74
Average	28.67	21.50	29.22	20.61
Maxima	39.69	48.37	58.12	30.17
Minima	11.11	9.150	5.320	10.56

Source: Ratios are computed on the basis of Revised Estimates from Annual Budgets Statements

entitled to special grants from the federal government. An important feature of these special grants is the indexation on the basis of CPI by the passage of time.

Conditional Transfers

Development Grants

The planning and development departments of the provincial governments prepare the Annual Development Programmes (ADPs) of their provinces. Following the approval of provincial ADPs by the Planning Commission of Pakistan, the federal government provides grants to the provincial government keeping in mind its own budgetary position.

The nature of grants for the Social Action Programme, Physical Planning and Housing Programme, Tameer–e–Watan Programme, Tameer–e–Sindh Programme are also of a conditional nature. See Table 13.3 for non-development grants which are more equalizing than development grants because the average magnitude of flow of non-development grants towards smaller relatively less developed provinces is higher than that of developed grants—see Table 13.4—however, on average both types of grants depict a similar pattern.

13.2.1 The Raisman Award 1951[9]

The Raisman Award was announced in 1951 without pre-defined constitutional arrangements. The vertical revenue sharing arrangement between the centre, provinces, and other federating units was 50:50 from the central divisible pool which consisted of income tax, sales tax, and excise duties. See Table 13.5 which shows that the ratio of distribution between East and West Pakistan was 45:55. Overall, this Award ensured the widening of the size of the divisible pool and shared more taxes as compared to the adhoc arrangements in place just after independence. Horizontal sharing was based on two principles: pre-assigned share and the derivation principle.[10] The distribution of income tax was based on a pre-assigned share with East Pakistan receiving 45 per cent, Punjab 27 per cent, Sindh 8 per cent, and Balochistan 0.6 per cent—see Table 13.5.

13.2.2 The National Finance Commission 1961–62

The announcement of the next Award was supposed to be made in 1956. However, almost ten years following the Raisman Award without any concrete development on the front of fiscal federalism, mainly due to continuous institutional decay and the dismal state of political and economic affairs in the country—see Table 13.6. Chief Martial Law Administrator General Ayub Khan instituted the National Finance Commission on 19 December 1961 with the constitutional mandate of developing a revenue

Table 13.4: Average Development Grants during Various NFC Awards

NFC Awards	Punjab	Sindh	KPK	Balochistan
1973–75	44.93	34.97	11.16	8.95
1976–79	46.42	25.68	16.27	11.63
1980–83	42.38	25.68	16.14	15.79
1984–91	34.57	34.08	9.57	21.79
1992–97	32.53	31.29	23.10	13.08
1998–06	32.36	27.20	25.61	14.83
2007–10	26.68	31.42	17.69	24.21
Average	37.12	30.05	17.08	15.75
Maxima	46.42	34.97	25.61	24.21
Minima	26.68	25.68	9.57	8.95

Source: Ratios are computed on the basis of revised estimates from Annual Budgets Statements

Table 13.5
Horizontal Revenue Distribution—Raisman Award 1951

Divisible Pool	Unit	East Pakistan	Punjab	Sindh	KPK (NWFP)	Bahawalpur	Khairpur	Balochistan	Remainder[1]	Total
Income tax[2]	per cent	45.0	27.0	12.0	8.0	4.0	0.6	0.6	2.8	100
Excise duties	per cent	45.0	27.0	12.0	8.0	4.0	0.6	0.6	2.8	100
Sales tax[3]	per cent	Rs. 18 mn[4]	54.0	16.0	10.0	4.0	0.1	1.5	14.4	100

1. The percentage allocation earmarked for princely states that may consent to accede to Pakistan like the state of Bahawalpur acceded to Pakistan on 7th October 1947 under Nawab Sadiq Muhammad Khan Abbasi.
2. Income tax collection other than the corporation tax and tax on salary of employees of federal government and their emoluments
3. The sales tax collection was the mandate of federation and the vertical distribution between centre and provinces was 50:50 ion derivation principle.
4. A minimum share of Rs. 18 million was guaranteed along with collection at source principle.

Source: Reports of National Finance Commissions

Table 13.6: NFC Awards in Historical Perspective

NFC Award	Instituted by	Commission appointed	Effective From	Consensus of provinces
Raisman	Prime Minister Liaquat Ali Khan	1951	1 April 1952	Conclusive
1961/2	President General Ayub Khan	19 December 1961	1 July 1962	Conclusive
1964	President General Ayub Khan	1964	1 July 1965	Conclusive
1970	President General Yahya Khan	17 April 1970	1 July 1970	Inconclusive
1974	President Fazal Ilahi Chaudhry	9 February 1974	1 July 1975	Conclusive
1979	President General Zia ul-Haq	11 February 1979	1 July 1983	Inconclusive
1985	President General Zia ul-Haq	25 July 1985	–	Inconclusive
1990	President Ghulam Ishaq Khan PPP Government dismissed Commission reconstituted	23 July 1990 6 August 1990 30 December 1990	1 July 1991	Conclusive
1997	President Farooq Ahmed Laghari	23 July 1995	1 July 1997	Conclusive
2006	President General Pervez Musharraf Commission reconstituted Commission reconstituted	2 July 2000 13 November 2003 21 July 2005	1 July 2006	Inconclusive
2010	President Asif Ali Zardari	24 July 2009	1 July 2010	Conclusive

Source: Compiled from reports of the National Finance Commission

sharing formula (vertical and horizontal) and settling the tax jurisdiction (tax assignment and tax sharing) between the federation and the provinces. Reforming borrowing powers and the debt and liabilities structure of the provinces was also the part of agenda before the NFC. The Award came into effect from 1 July 1962 vide Presidential Order No. 23 of 1962 'The Distribution of Revenues and Consolidation and Repayment of Loans Order, 1962'.

Earlier, the government of Prime Minister Chaudhry Muhammad Ali, under rationalization of administrative reforms and to reduce the provincial expenditures and prejudices, had launched the One Unit[11] system under which the four provinces of West Pakistan were merged and declared as one province, with Lahore as provincial capital, and East Pakistan was declared the other province with Dhaka as provincial capital. After the formation of the one unit the horizontal revenue sharing came to be defined for the two provinces on the basis of 54:46 (East Pakistan:West Pakistan).

Unlike the Raisman Award, vertical sharing was not that simple, a heterogeneous mix of criteria for different kind of taxes was introduced to be vertically shared between the federation and the two provinces. The allocation of income tax was 50 per cent (minimum percentage allocation of any tax in this Award). Sales tax and excise duties were set out to be 60 per cent and all other taxes; export and import duties were allocated 100 per cent to the provinces.

As Table 13.7 shows, the horizontal distribution formula was primarily based on two criteria: pre-assigned shares (approximating the provincial populations), while the other taxes were shared on the basis of the collection principle. Income taxes, excise, and export and import duties, were shared on the basis of a pre-assigned share and sales tax was shared 30 per cent on collection basis and 70 per cent on a

Table 13.7
Criteria for Horizontal Distribution of Divisible Pool under National Finance Commission NFC Pakistan

Criteria of Horizontal Distribution	National Finance Commission Awards												
	Before 1971								1971 to Date				
	Raisman Award 1951			1961–62		1964	1970		1974	1990	1996	2006*	2010
	Sales Tax	Income Tax & Excise	Export Duties	Sales Tax	All Other Taxes	All Taxes	Sales Tax	All Other Taxes	All Taxes Less Import Duties	All Taxes Less Import Duties	All Taxes	All Taxes	All Taxes
	Percentage												
Collection	50	–	–	30	–	–	30	–	–	–	–	–	–
Pre Assigned Shares	50	100	100	70	100	100	70	100	–	–	–	–	–
Population	–	–	–	–	–	–	–	–	100	100	100	100	82.0
Poverty and Back-wardness	–	–	–	–	–	–	–	–	–	–	–	3**	10.3
Revenue Collection/ Generation	–	–	–	–	–	–	–	–	–	–	–	–	5.00
Inverse Population Density	–	–	–	–	–	–	–	–	–	–	–	–	2.70

Source: Table designed by author and statistics are compiled from reports of National Finance Commissions (various issues).
* Presidential order 1 of 2006. In 2006 there was no consensus as to formulation of award therefore; President Pervez Musharraf passed a presidential order.
**The allocation of Grant out of this 3 per cent allocated among the four provinces was as Punjab (11 per cent), Sindh (21 per cent), KPK (35 per cent) and Balochistan (33 per cent). No scientific approach was adopted for the distribution.

pre-assigned share. Succession duties on agricultural land and capital value tax on immovable property, were fully assigned to the provinces. Further, the provinces were provided with a special concession of 50 per cent on their federal outstanding liabilities up to 30 June 1961 and the remaining 50 per cent loan was converted into a single loan of twenty five years carrying a mark-up rate of 3.5 per cent per annum.

13.2.3 The National Finance Commission Award 1964

After two years of the imposition of Martial Law by General Ayub Khan, a Constitution Commission was set up on 17 February 1960. The objective of the Commission was to submit a report to the President about the provisions of strengthening democracy, socioeconomic justice, and Islamic principles of justice. The report was submitted on 29 April 1961 and later the new Constitution of Pakistan, 1962 was promulgated and announced on 1 March 1962.

In pursuance of powers conferred upon him under Article 144(1) of the Constitution of 1962, the President instituted a National Finance Commission before the earlier Commission would have lapsed. In the case of vertical distribution, this Award performed better than the preceding one and allocated a comparatively higher share of 65 per cent to the provinces from the federal divisible pool comprised of income and corporate taxes, sales tax, excise duty on tea, tobacco, and betel nut, and export duties on jute and cotton—see Table 13.8. The horizontal criteria remained unaltered for the two provinces as that of NFC 1962, i.e. 54 per cent allocated to East Pakistan and 46 per cent to West Pakistan. The final recommendations of the Commission were applicable with effect from 1 July 1965 for a period of five years up to 30 June 1970.

In September 1965 war with India broke out and later in 1968 mass level unrest began. The situation was triggered by rising inequalities and disparities in the country. The controlled price of one kilo of sugar was increased by one rupee which led to mass agitation and extreme resentment, bringing people onto the streets. The situation ended with many casualties, following which Ayub's popularity declined. With this, came the time for the sunset of his dictatorial regime. He decided to hand over power to the Chief of Army Staff General Aga Muhammad Yahya Khan who declared another Martial Law after assumption of the office of President of Pakistan and Chief Martial Law Administrator (CMLA) on 25 March 1969.

Table 13.8
Vertical Revenue Sharing Arrangements between Federal and Provincial Governments under Various NFC Awards

Divisible Pool Taxes	National Finance Commissions														
	Before 1971				1971 Onwards										
								NFC 2006[29]					NFC 2010		
	Raisman 1951	1962	1964	1970	1974	1990	1997	2007	2008	2009	2010	2011	2011	2012 Onwards	2013
	Cumulative Percentage Share of Provincial Governments														
Income Tax & Corporation Tax[30]	50.0	50.0	65.0	80.0	80.0	80.0	37.5	41.5	42.5	43.75	45.0	46.25[31]	56.0	57.5	57.5
Wealth Tax	–	–	–	–	–	–	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Sales Taxes[32]	50.0	60.0	65.0	80.0	80.0	80.0	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Excise Duty	–	–	–	–	–	–	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Tea	50.0	60.0	65.0	80.0	–	–	–	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Tobacco	50.0	60.0	65.0	80.0	–	80.0	–	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Sugar	–	–	–	–	-	80.0	–	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Betel nut	50.0	60.0	65.0	80.0	–	–	–	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Export Duties	–	–	–	–	–	–	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Cotton	–	100.0	65.0	80.0	80.0	80.0	–	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Jute	62.5	100.0	65.0	80.0	–	–	–	–	–	–	–	–	–	–	–
Import Duties	–	–	–	–	–	–	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Estate/Succession Duties	–	100	–	100.0	–	–	37.5	41.5	42.5	43.75	45.0	46.25	56.0	57.5	57.5
Capital Value Tax on Immovable Properties*	–	100	–	100.0	–	–	37.5	41.5	42.5	43.75	45.0	–	–	–	–
D.P Transfers as % of Fed Total Tax Revenue**	12.8	23.1	27.0	33.4	22.8	38.0	35.0	36.7	32.92	41.1	43.3	53.6	53.6	56.5	56.8

*Devolved after the passage of 18th amendment to the Constitution of Pakistan, 1973
**Calculated from data of FBR Year Books and Explanatory Memorandum of Budgets (various issues).
Source: Author's tabulation from the reports of National Finance Commissions/Distribution of Revenues and Grants-in-Aid Orders of President of Pakistan.

On 31 March 1970 the President promulgated the Legal Framework Order (LFO), 1970, under which One Unit was dissolved and the provinces Punjab, Sindh, and NWFP (now KPK) were restored to their status prior to 22 November 1954, and a full-fledged province of Balochistan was created. Elections for a unicameral legislature and National Assembly were called under the mandate of Legal Framework Order (LFO). Unlike the Constitution of 1956 which ensured equal representation of the East and West wing, of 40 members each, the LFO declared proportionate representation for the two wings. The more populous wing East Pakistan, was allotted a share of 162 seats and West Pakistan 138 seats. The horizontal share of East and West Pakistan remained unaltered at 54:46. The decision of the dissolution of the One Unit system led to the distribution of the 46 per cent horizontal share of West Pakistan among the provinces to Punjab 56.5 per cent, Sindh 23.5 per cent, NWFP 15.5 per cent, and Balochistan 4.5 per cent.

13.2.4 The National Finance Committee 1970

Just after the dissolution on 17 April 1970, Yahya Khan constituted a Committee instead of carrying on a legacy of instituting a high-powered National Finance Commission. The committee was constituted under the Chairmanship of Nawab Muzzaffar Ali Khan Qizilbash, the then Finance Minister in the cabinet of the CMLA. The terms of reference of the Committee were to re-examine the existing arrangement of intergovernmental fiscal relations in the country and to recommend to the President on the vertical (between federation and provinces) and horizontal (between provinces) revenue sharing formula.

The Committee generously increased the vertical sharing by 15 per cent, i.e. now 80 per cent of the divisible pool resources were to be allocated to the provinces. The rationale behind this increase could have been to reconcile with the increasing disparities amongst the provinces and to grant the sub-national governments more fiscal powers. The overall size of the divisible pool as a percentage of federal taxes increased from that of the preceding one, by a significant percentage of 6.4 per cent, i.e. from 27 per cent to 33.4 per cent (see Table 13.8). On account of horizontal revenue sharing, the Award witnessed no change in the criteria—see Table 13.7.

The first general elections held in 1970 after the independence of Pakistan led to the Awami League of Sheikh Mujib-ur-Rehman winning 160 seats out of 162 in East Pakistan based on his Six Points campaign demanding greater provincial autonomy. PPP emerged as the second largest party with 81 seats. Yet Mujib was denied formation of his government in the National Assembly. In Operation Searchlight by the Pakistan Army, he was arrested on 26 March 1971. During his arrest and due to denial, despite attaining a 55 per cent majority, immense crisis erupted in East Pakistan. Later the crises became a movement of civil disobedience leading to military suppression by the Pakistan Army, resulting in East Pakistan becoming Bangladesh on 16 December 1971 after the surrender by Lieutenant-General A. A. K Niazi, joint commander of Pakistan before Lieutenant General Jagjit Singh Aurora, joint commander of the Bangladesh-India Allied Forces. After the fall of East Pakistan, CMLA General Yahya Khan handed over power to Zulfikar Ali Bhutto, the leader of PPP who had gained victory in West Pakistan. Z. A. Bhutto assumed office on 20 December 1970 as President and first Civilian Martial Law Adminstartor (CMLA) of Pakistan.

On the fiscal federalism front post-1971, the share of East Pakistan was retained by the federal government on account of managing its priorities and to meet its huge expenditure needs in rebuilding the country. The provinces in West Pakistan (present Pakistan) continued to enjoy their respective shares out of the 46 per cent of the vertical share. The average vertical fiscal imbalance was 40.3 per cent (see Table 13.9) during the period 1972/3 to 1974/5, which is the highest from 1971 to date. One major change and shift in the course of federalism was a sharp decline in the collection of taxes. Export duties on jute and other taxes had been contributing a huge share to that effect. On the external account, the export of jute had been the main source of exchange earnings.

Table 13.9
Average Vertical Fiscal Imbalance between Federal and Provincial Governments—NFC Award Period

NFC Awards	1972–75	1976–80	1981–91*	1992–97	1998–06	2007–09	2010–13	Maxima	Minima
Revenue Share					per cent				
Federal	85.8	89.9	92.6	94.3	94.0	93.1	93.8	94.3	85.8
Provincial	14.2	10.1	7.4	5.7	6.0	6.9	6.2	14.2	5.7
Expenditure Share					per cent				
Federal	45.5	63.1	75.0	73.4	72.9	69.2	71.8	75.0	45.5
Provincial	54.5	36.9	25.0	26.6	27.1	30.8	28.2	54.4	25.0
Vertical Imbalance					per cent				
Federal	40.3	26.8	17.6	20.9	21.1	23.9	22.0	40.3	17.6
Provincial	–40.3	–26.8	–17.6	–20.9	–21.1	–23.9	–22.0	–40.3	–17.6

*No Award was announced during this period.
Source: Calculated from the data of Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

13.2.5 The National Finance Commission Award 1974

The second phase of the intergovernmental fiscal relations in Pakistan starts from 1971. West Pakistan (present Pakistan) administratively consisted of four provinces and federating units such as FATA, Gilgit-Baltistan[12], and Azad Kashmir. Although the federating units other than the provinces were not covered under the mandate of NFC Awards, provision of special grants was functional.

Meanwhile, on 17 April 1972, Bhutto invited all parliamentary parties for a meeting which ended with a consensus on the need for a new constitution for Pakistan. PPP appointed a 25-member committee on 17 October 1972 under the chairmanship of Abdul Hafeez Pirzada to prepare a draft for the new constitution. The draft bill of the new constitution was moved in the National Assembly on 2 February 1973 and passed by the Assembly unanimously on 19 February 1973.

Another important development was the population census of 1972 which was delayed by one year due to the insurgency in East Pakistan and war with India. As Table 13.10 shows, the census revealed that the composition of shares of provinces, changed, and the share of Punjab and NWFP had declined by 2.15 per cent (from 62.09 per cent to 60.09 per cent) and 0.60 per cent (from 14.01 per cent to 13.41 per cent), respectively in the national population. Sindh and Balochistan experienced an increase in their share in the population by 2.17 per cent (from 20.45 per cent to 22.62) and 0.57 per cent (from 3.31 per cent to 3.88 per cent), respectively.

Articles 160 to 165 of the Constitution of Pakistan, 1973 describe the role of the National Finance Commission, the role of federation and provinces' and ancillary matters. On 9 February 1974 the NFC was constituted in pursuance of Article 160 of the new Constitution. The major changes this time were inclusion of fewer taxes in the federal divisible pool, i.e. income and corporation tax, sales tax, and export duties. The vertical revenue sharing arrangement between federation and provinces remained the same 20:80 (Federation:Provinces). While horizontal sharing was simplified and based on the latest available statistics on the share of the population of the provinces, population was made the sole criterion for distribution of divisible pool resources. This remained the sole basis for horizontal distribution up to the 2010 Award. It is believed that this situation resulted in the dominance of Punjab—the reasons for Punjab's dominance were many—one of them being that Punjab had the largest representation in the National Assembly on the basis of population.

The Commission recommended that the provinces of NWFP and Balochistan were relatively less developed compared to the rest; therefore, on account of their poverty and backwardness, federation subventions of Rs. 100 million and 50 million, respectively, were fixed for them. Special maintenance grants for highways and agency work were approved in this Award. No ceiling was imposed on the borrowing limits of both tiers of government. The provisions of this Award were functional with effect from 1 July 1975.

Chief of Army Staff General Zia ul-Haq proclaimed the third Martial Law in the country on 5 July 1977 and promised to hold general elections in three months; however, he remained in power for a period of eleven years. The Zia government filed a murder case against former Prime Minister Bhutto and awarded death sentence to him.

13.2.6 The National Finance Commission Awards, 1979 and 1985

On 11 February 1979 President Zia asked the National Finance Commission to make its recommendations about vertical and horizontal revenue sharing and to suggest improvements in intergovernmental fiscal relations. Perhaps this is the only such Award in history which was not announced, as not a single meeting of the members of the Commission was held until 1983. Therefore, the provisions of the NFC 1974 Award continued on an ad hoc arrangement with a change in percentage shares of population of provinces in the national population as per the 1981 census, i.e. Punjab 57.88 per cent, Sindh 23.29 per cent, NWFP 13.54 per cent, and Balochistan 5.30 per cent—see Table 13.10. The relative shares of all provinces in the population increased with the exception of Punjab. As Table 13.10 shows, the relative share of Punjab declined by 2.21 per cent (from 60.09 per cent to 57.88 per cent) and Sindh, NWFP, and Balochistan on the other hand registered an increase of 0.67 per cent (from 22.62 per cent to 23.29 per cent), 0.13 per cent (from 13.41 per cent to 13.54 per cent), and 1.42 per cent (from 3.88 per cent to 5.30 per cent) compared to the earlier population census. The recommendations of the Award were made effective from 1 July 1983.

Table 13.10
Trends in Regional Distribution of Population among Federating Units of Pakistan

Rank*	Provinces	Census 1 1951	Census 2 1962	Census 3 1972	Census 4 1981	Census 5 1998	Estimated 2005**	Estimated 2010**	Estimated 2013**
1st	Punjab	63.57	62.24	60.09	57.88	57.36	56.78	56.36	56.11
2nd	Sindh	18.72	20.45	22.62	23.29	23.71	24.23	24.54	24.69
3rd	KPK	14.10	14.01	13.41	13.54	13.82	13.81	13.84	13.88
4th	Balochistan	3.61	3.31	3.88	5.30	5.11	5.19	5.27	5.32

*Position of Provinces and other federating units of Pakistan with respect of share in total population in descending order (from highest to the lowest in vertical columns)
** *Pakistan Economic Survey 2012–13*
Source: Author's compilation from *Census of Population* (Islamabad: Population Census Organization, various issues).

All three dictators, Ayub, Zia, and Musharraf, had the privilege of instituting the National Finance Commission twice during their rule. On 25 July 1985 in pursuance of powers conferred upon him under Article 160, Zia constituted another National Finance Commission. The terms of reference for this Commission were the same as of the earlier Award. Nine meetings were held and no consensus upon horizontal revenue distribution was arrived at by the provinces. The President declared the 1974 NFC Award to remain effective with the population shares of 1981 census being effective.

In 1985 non-party-based general elections were held, and Muhammad Khan Junejo was nominated as the tenth Prime Minster of Pakistan. Later on the legislature approved the 8th Constitutional Amendment and legitimized all acts including the Martial Law of 1977. After the passage of this amendment basic fundamental rights were restored and Martial Law was lifted by Zia. After the investigation of the Ojhri Camp incident, Junejo made a statement on the floor of the House that the report of the findings of investigation on the Ojhri Camp incident would be placed before the House. This raised serious concerns in the military leadership and Zia dismissed Junejo on 29 May 1988. He announced fresh elections to be held within three months but no elections were held until his death in a plane crash near Bahawalpur on 17 August 1988. Following the death of Zia, General Aslam Baig was nominated as COAS and Chairman Senate Ghulam Ishaq Khan took charge as Caretaker President. The President announced general elections to be held on 16 November 1988 to elect 336 members of the National Assembly and 100 senators. Pakistan People's Party emerged victorious and Benazir Bhutto took oath as the Prime Minster on 2 December 1988. On charges of corruption and nepotism, her government was dismissed by the President exercising his powers under Article 58(2)b. The President then announced new elections and PML–N emerged as the victorious party and formed the government. Prime Minster Mian Nawaz Sharif took charge on 6 November 1990.

13.2.7 The National Finance Commission Award 1990

It is the constitutional responsibility of the President to constitute the National Finance Commission after every five years. However, this Commission was constituted sixteen years after the NFC of 1974. Although the two Commissions of 1979 and 1983 were constituted, both failed to reach a consensus. Due to the long delay in the announcement of the Award, revenue deficit grants were allocated to the provinces by the Federation, especially in the late 1980s. This delay raised valid expectations amongst the provincial governments that the financing of the provincial revenue deficit was guaranteed, which resulted in massive increase in recurring expenditures of the provinces. Further, this delay aggravated a sense of deprivation amongst the three provinces Sindh, NWFP, and Balochistan due to Punjab enjoying a larger share of the pie due to its relatively large share in the population given that the divisible pool distribution continued from the 1974 NFC Award population-based formula.

On 23 July 1990 the President constituted the National Finance Commission under Article 160 of the Constitution. The Commission consisted of ten members initially. Later, upon the advice of the newly elected Prime Minster, four new non–statutory members (one from each province) replaced the existing ones. In addition to the recommended vertical and horizontal distribution, the mandate of the 1990 Commission was to advise the President on the comprehensive mechanism for the distribution of proceeds of natural resources (royalties on crude oil and surcharges on natural gas). Furthermore, the Commission was asked to suggest a procedure of grant-in-aid and made recommendations on the borrowing powers for the federation and provinces.

In order to rationalize further the regime of federalism and to increase the size of the divisible pool, excise duties on tobacco, tobacco manufactures, and sugar were added to the existing stream of taxes comprising the divisible pool. Another important development was to recognize the right of provinces to profits and royalties arising out of the use of their indigenous resources, such as development surcharges on natural gas, profits on hydroelectricity, and royalty on crude oil.

Using the principle of production basis, gas development surcharge was paid to the provinces after deduction of 2 per cent collection charges by the collecting agency—the federal government. Net profit of hydro-electricity was paid to the provinces on the basis of the location principle. Royalty from crude oil was also paid to the provinces on the basis of the production principle. This Award recommended royalty and excise duties on natural gas to be paid to the provinces. This kind of revenue transfer system is called a 'straight transfer', meaning revenues arising out of indigenous resources are credited directly to provincial accounts by the collecting agency on the origin principle. Straight transfers increased the fiscal space for the relatively less-developed provinces NWFP and Balochistan due to concentration of natural resources in the these provinces.

In the 1990 Award, vertical and horizontal criteria were same as in the previous Award. Vertical sharing was 80:20 (Provinces:Federation) and horizontal sharing was based on the last available population census of 1981.

The provision of grants for the revenue deficit of the sub-national governments in fact incentivized them to incur huge expenditures and ignore own-source revenue efforts, relying primarily on federal transfers. The Award made the provinces themselves responsible for the surpluses or deficits by abolishing federal grants for provincial revenue deficits. However, the Award legitimized fixed annual subvention/grants to the provinces—see Table 13.11.

13.2.8 The National Finance Commission Award 1997

After the dismissal of the first Nawaz Sharif government in 1993, and after Benazir Bhutto had won the elections to become Prime Minister a second time in 1993, President Farooq Laghari instituted the National Finance Commission on 23 July 1995 with the mandate to make recommendations on vertical and horizontal revenue sharing and in light of

Table 13.11
Fixed Subvention to the Provinces: NFC 1990

Provinces	Rs. in million	Period
Punjab	1000	3 years
Sindh	700	5 years
KPK	200	3 years
Balochistan	100	3 years

Source: Compiled from Report of National Finance Commission

appraisal of earlier Awards. The Commission comprised of the Federal Minister Finance as Chairman, four provincial ministers, four non-statutory members each from one province, advisor to the Prime Minister, and Federal Secretary Finance. There were a couple of important developments in this Award.

First of all, the Award signalled the expansion in the divisible pool by inclusion of all taxes including custom duties, which was not part of the pool in earlier Awards. The new divisible pool after expansion contained income and corporate taxes, wealth tax, capital value tax, sales tax, custom duties, and excise duties (excluding excise duty on gas, charged at wellhead).

In every Award the vertical share was either retained, as in the preceding Award, or increased substantially. On account of vertical revenue sharing, this is the only Award in history where the share of provinces was cut down by a huge 42.5 per cent compared to the earlier Award, i.e. from 80 per cent to 37.5 per cent. Moreover, the divisible pool as a percentage of federal tax revenues was also decreased substantially by three per cent (from 38 per cent to 35 per cent)—see Table 13.8. The argument of the federation was that the earlier Award vertically shared a higher share but with fewer number of taxes; but now that the vertical share had been decreased and the pie of the divisible pool expanded, the provinces would no longer be in loss. Furthermore, the distribution of straight transfers continued as per the established formula of the 1992 NFC Award.

The allocation of the annual fixed subvention arrangement by the federation under the 1997 Award was Rs. 4,080 million and Rs. 3,320 million, for Balochistan and NWFP, respectively. An annual increase of 11 per cent to the fixed subvention was proposed subject to further revision due to indexation according to prevailing inflation in the future.

For the first time in Pakistan, the concept of matching grants against the sub-national fiscal effort was recommended by the Commission. The scope of the provincial fiscal effort was defined as an increase in the rate of provincial taxes, withdrawal of exemptions, imposition of new taxes, and revision and updation in rates of user charges. Provincial own-source revenues equal to or greater than 14.2 per cent growth subject to a maximum upper limit of Rs. 500 for Punjab and Rs. 100 million for Sindh, NWFP, and Balochistan was assured.

Another important step by the federation in the 1997 Award was to abolish the octroi *zila* tax. In lieu of the octroi tax, the federal government increased the rate of general sales tax (GST) from 12.5 per cent to 15 per cent. The provinces were guaranteed under the head of non-development grant, transfer of an amount equal to 2.5 per cent (additional GST revenue) on the basis of octroi estimates on the base year 1998.

On macroeconomic reforms, Pakistan was pursuing a Structural Adjustment Programme of the IMF for rationalizing the tariff regime and taxation structure to reduce the fiscal deficit which resulted in reduction in revenues—also see Chapter 17. Moreover, just after Pakistan tested its nuclear devices, international sanctions were imposed coupled with recession in the international and domestic economy, and economic activities were hampered—see Chapter 18. As a whole, provinces suffered the most because they had agreed to a 45.2 per cent (from 80 per cent to 37.5 per cent) reduction in their vertical share and horizontal sharing was only based on the population criterion.

13.2.9 The National Finance Commission Award 2006

12 October 1999 witnessed the fourth regime military in Pakistan's history. COAS General Pervez Musharraf took charge as Chief Executive of the country. Under the Musharraf regime the President constituted the National Finance Commission three times, since the first one on 2 July 2000, but as no recommendations came forward, the President constituted the Commission again on 13 November 2003. Eleven meetings of the Commission were held within two years but no criteria on vertical and horizontal sharing were agreed. The government's intention was to reform the existing system and establish a just and fair mechanism for intergovernmental fiscal transfers in the country. Smaller provinces had many reservations on various matters of national importance including the Kalabagh Dam, the water distribution formula by the Indus River System Authority (IRSA), and the National Finance Commission. The bone of contention for not agreeing the formula was actually the vertical sharing arrangement. The provinces demanded a minimum guaranteed share of 50 per cent in the federal divisible pool due to which differences with the federation could not be resolved.

On horizontal distribution, the three smaller provinces Sindh, NWFP, and Balochistan had varying arguments and reservations. Therefore, the NFC should have worked for a redress of the legacy of the preceding Awards which the Commission could not manage to do. Sindh's argument was to make part of the allocation on the basis of revenue collection and generation in which Sindh had absolute advantage, mainly on account of the port facility which gave Karachi/Sindh monopoly over collection of indirect taxes, such as the sales tax, FED on imports and custom duties—for further details see Chapter 23 on Karachi. NWFPs and Balochistan's arguments were based on the poverty and backwardness criteria with one argument specific to Balochistan based on area, i.e. inverse population density. However, Punjab was not ready to move an inch from its position on population-based transfers.

As a result, the President constituted the Commission for a third time on 21 July 2005, but the difference still persisted between representatives of all the provinces. Therefore, under article 160(1) of the Constitution, the President exercised his powers and a formal arrangement of transfers was announced vide 'Distribution of Revenues and Grants-in-Aid (Amendment) Order, 2006', President Order No. 1 of 2006.

The order was made applicable with effect from 1 July 2007. Horizontal sharing continued on the population principle, perhaps because the military president, General Pervez Musharraf, did not want resentment from the largest province whose representation in the population, the National Assembly, and the military was dominant. However, the vertical sharing arrangements took into account the growing needs of the provinces and increased the vertical share from 37.5 per cent to 41.5 per cent in the first year of the Award, i.e. fiscal year 2007. In the second year an increase from 41.5 per cent to 42.5 per cent and from the third year to the fifth an increase of 1.25 per cent was recommended; therefore, the proposed allocation for the fiscal year 2011 was 46.25 per cent—see Table 13.8. These annual increments were made a feature of the Awards for the first time in Pakistan.

The Revenue Order, 2006, revised the 1/6th distribution of sales tax to the provinces to compensate for the octroi losses. The revised formula was based on collection (Punjab 50.0 per cent, Sindh 37.5 per cent, NWFP 9.93 per cent, and Balochistan 5.22 per cent) and 1998 population share (Punjab 57.36 per cent, Sindh 23.71 per cent, NWFP 13.82 per cent, and Balochistan 5.11 per cent) on a 50:50 basis.

Provisions of special grants by the federation to the provinces were incorporated into this Award. An amount of Rs. 27.5 billion was allocated for this purpose to be increased annually according to growth in taxes. The provisions of allocations for these grants were mainly judgmental and did not follow any scientific approach or equalization needs. The share allocation was Punjab 11 per cent, Sindh 21 per cent, NWFP 33 per cent, and Balochistan 35 per cent. However, the relative shares were indicative that these transfers would have created fiscal equalization, and an objective empirical assessment would reinforce the same.

Fiscal year 2007/8 brought much unforeseen and unexpected turmoil and difficulties for Pakistan's economy due to extreme political unrest and several economic events in the international world. Some of these events were poor law and order, adverse supply shocks, sharp rise in prices in oil, food and other non-food consumable items, and a financial meltdown in the international market. The situation was coupled with political unrest in the country which aggravated when the President imposed an Emergency on 3 November 2007 and the judges of the Supreme Court were detained unlawfully. This spurred the judges' restoration movement country-wide. Meanwhile, general elections were first called for 2007, but had to be postponed until 2008 following the assassination of Benazir Bhutto. The PPP emerged as the majority party and formed the government in the centre, and in Sindh, NWFP, and Balochistan. The Punjab government was formed under PML–N. Asif Ali Zardari was elected as President of Pakistan on 6 September 2008, replacing General Musharraf.

13.3 The National Finance Commission Award 2010

Before the time frame of the NFC Award of 2006 would have expired in 2011, President Zardari under Article 160 of the Constitution of Pakistan 1973, constituted the National Finance Commission on 24 July 2009 and assigned the mandate of rationalizing the present stream of fiscal federalism in Pakistan. *This was the first time since the separation of East Pakistan that the design of intergovernmental fiscal transfers was redefined and redressed.* The most important move in this direction has been the structural shift towards multiple criteria based on revenue distribution (see Table 13.7), rather than on the basis of population alone, which was the basis of previous Awards—also see Tables 13.12 and 13.13. Most surprisingly, Punjab gave up a portion of its share, 5.62 per cent, and the redistributive effect was that Sindh gained 0.84 per cent, and NWFP 0.80 per cent; moreover, the special needs of Balochistan were considered and a significant addition of 3.98 per cent was made possible to its share—see Table 13.13. Furthermore, the federation sacrificed more than 10 per cent of its share compared to the 2006 NFC Award and distributed it to the provinces—see Table 13.8. The province of Khyber Pakhtunkhwa (KPK)had been badly affected by the War on Terror, and the present Award was supplemented by a special provision of assigning one per cent of the net proceeds of the divisible pool taxes to the KPK government to meet its additional expenses as a consequence of the war. Table 13.13 shows that the net impact to the two provinces, Sindh and KPK, was nearly equal, which seems in opposition to rationality, because both the provinces differ greatly in terms of their socio-economic indicators, and therefore, the gains may not be similar due to the large differences between the

Table 13.12
Net Effect of Multiple Criteria 2010 Compared to Population-based Criterion

Provinces	Horizontal Distribution Based on Population 1998	Horizontal Distribution Multiple Criteria 2010 (82% of 1998 Population)	Change in Horizontal Shares Due to NFC 2010
	per cent		
Punjab	57.36	51.74	–5.62
Sindh	23.71	24.55	+0.84
KPK	13.82	14.62	+0.80
Balochistan	5.11	9.09	+3.98
Total	**100**	**100**	**0.00**

Source: Compiled from data from the Population Census 1998 and NFC 2010.

two provinces. In the next sections, we discuss these multiple criteria with some empirical analysis. We will discuss the pros and cons and the potential future agenda for fiscal federalism reforms in Pakistan.—also see Boxes 13.1 and 13.2.

13.3.1 Population Criteria

Pakistan has been amongst the top ten most populous countries of the world. Though the inter-census growth rate of population has been declining over the period in Pakistan (see Table 13.14), the rate of growth is still higher than the average growth rate of South Asian and developing countries. As Table 13.14 shows, in the case of Sindh the overall population growth has decreased to 2.62 per cent from 4.06 per cent in 1951–61, 4.51 per cent in 1961–72, and 2.75 in 1972–81.

For a social planner the situation is fairly complex: should dividing the pool of divisible resources be on a population basis as it has always been? If yes, then why should fiscal intervention not take into account the highly diverse population attributes of all federating units and their dynamics over time such as growth rates in rural and urban regions, large and small cities? These are questions which need to be asked.

Two of the criteria, for the NFC Award 2010 are based on population, i.e. population and inverse population density, which highlights the importance of the availability of reliable, updated estimates. The NFC Award 2010 calculated the respective 82 per cent shares of provinces on the basis of their share of population in the population according to the fifth census of 1998—see Table 13.10. (Punjab: 82 per cent of 57.36 = 47.04, Sindh 82 per cent of 23.71 = 19.44, KPK 82 per cent of 13.82 = 11.33, and Balochistan 82 per cent of 5.11= 4.19)—see Graph 13.1.

Although the consensus on the multiple criteria recommended by the NFC Award 2010 is path-breaking and has changed the course of fiscal federalism in Pakistan, nevertheless, the criterion of population has been given extraordinary weightage, which could sacrifice the equalization objectives of fiscal federal transfers. Before 2010, Pakistan always practiced the exclusive population-based criterion to distribute divisible pool taxes, which in reality resulted in the dominance of Punjab on account of its largest share in the population. This aggravated the sense of deprivation and economic injustice amongst the other provinces. The structural change in the formula of the divisible pool, i.e. multiple criteria, is considerable progress on the contemporary canvas of fiscal federalism in Pakistan. The share of Punjab has substantially been redistributed amongst the relatively less developed provinces and its traditional dominance has been voluntarily sacrificed—see Graphs 13.1 and 13.2, and Table 13.12 and Table 13.13.

Table 13.13
Horizontal Revenue Sharing: Provincial Share in NFC Awards 1971 to date

Provinces	1970	1974	1979	1990	1996	2006	2010	Change*
Punjab	56.50	60.25	57.97	57.88	57.88	57.36	51.74	–5.62
Sindh	23.50	22.50	23.24	23.28	23.28	23.71	24.55	+0.84
KPK	15.50	13.39	13.49	13.54	13.54	13.82	14.62	+0.80
Balochistan	4.500	3.860	5.300	5.300	5.300	5.110	9.090	+3.98
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**0.00**

*Due to multiple criteria Punjab has sacrificed its share and other three provinces gain net off. The difference is computed by subtracting share allocated in 2006 from the share allocated under multiple criteria.
Source: Reports on National Finance Commission (various issues).

Table 13.14
Trends in Position of Federating Units of Pakistan—Annual Intercensal Population Growth Rates

Rank*	1951–1961				1961–1972				1972–1981				1981–1998			
		Overall	Urban	Rural		Overall	Urban	Rural		Overall	Urban	Rural		Overall	Urban	Rural
1st	S	4.06	6.79	2.71	B	4.51	4.28	4.55	B	7.09	7.21	7.21	K	2.75	3.47	2.62
2nd	K	3.07	4.91	2.82	S	3.98	4.57	3.6	S	3.56	2.96	2.96	S	2.71	3.45	2.09
3rd	P	2.92	5.12	2.4	P	2.77	3.93	2.43	K	3.33	3.21	3.21	P	2.55	3.31	2.24
4th	B	2.23	5.46	1.7	K	2.69	3.36	2.59	P	2.75	2.23	2.23	B	2.48	4.81	1.93
	PK	3.18	5.56	2.57	PK	3.04	4.13	2.7	PK	3.06	4.38	2.58	PK	2.61	3.45	2.25

Position of Provinces and other federating units of Pakistan with respect to inter census total population growth rates in descending order (from highest to lowest in vertical columns).
S = Sindh, P= Punjab, K = Khyber Pakhtunkhwa, B = Balochistan and PK = Pakistan.
Source: Author compilation from Census of Population Various Issues (Islamabad: Population Census Organization, various issues).

Box 13.1

The New Fiscal Federalism

Ishrat Hussain examines the new fiscal federalism and writes:

Most of the pre- and post-budget seminars, TV shows and discussions, and public discourse this year focused exclusively on the federal budget. Past traditions are hard to break but the new realities in our face should wake us up.

The 7th NFC Award and the 18th amendment to the Constitution have brought about a fundamental structural change in the fiscal affairs of Pakistan. The federal government is no longer the main driver of fiscal policy. Power and resources have shifted, rightly so, to the provinces. The share of the federal government in the net proceeds of the divisible pool has come down to 42.5 per cent while that of the provinces has gone up to 57.5 per cent. Adding straight transfers, grants/subventions, and development loans to the provinces pushes this share further up.

In the last four years, the total outlay of the provincial governments has risen from almost Rs. 1,000 billion to Rs. 1,800 billion—an increase of 80 per cent. Almost 89 per cent of this amount has been financed by the federal transfers, which have almost tripled from Rs. 520 billion to Rs. 1545 billion. Only 11 per cent has been raised by the provincial governments from their own revenues—tax and non-tax. In 2007–08, the provinces' own contribution to the total outlay was 15 per cent.

How has this increase in federal transfers affected the pattern of expenditures? The share of development expenditure in total expenditure has declined from 34.5 per cent to 33.3 per cent while that of current expenditure has risen from 65.6 per cent to 66.7 per cent.

It was widely believed that as the provinces spend most of their money on education, health, drinking water, agriculture & irrigation, the ordinary citizen would benefit from this transfer of resources from the federal to the provincial governments. Preliminary estimates show that this assumption has not proved to be true. Punjab has allocated only six per cent of the total outlay while Khyber Pakhtunkhwa seven per cent for health and education. Only Sindh has increased the allocations this year.

The devolution process remains incomplete as the functions, authority, and resources have not been delegated to the district governments. As there is an administrative vacuum at the district level, most of the financial resources that were accruing to the districts are now retained by the provincial governments.

While the provinces are now quite flush with resources that are derived from the divisible pool, the federal government is stuck in a difficult fiscal situation. As most of the rigid and inflexible expenditures such as debt servicing, defence, civil armed forces, and subsidies fall upon the federal government, it faces financing problems in the face of a declining share in the overall tax pool. The growing fiscal deficit cannot be brought under control because of the asymmetry in the assignment of revenues and location of responsibility for expenditure. The financing of the fiscal deficit by borrowing from the State Bank of Pakistan has kept inflation high. Macro-economic stability remains elusive, investor uncertainty prevails, and growth is subdued.

We have to recognize the new realities of fiscal federalism for Pakistan. Attention and policy objectives have to shift from the federal to the provincial governments. Institutional arrangements of the past are no longer adequate to respond to the challenges of the future. New institutional arrangements and policy changes have to be put in place. What are these?

First, the present practice of budget formulation by the federal and provincial governments in isolation has to be replaced by an integrated budgetary framework prepared, discussed and debated at the Council of Common Interests (CII) and approved by the National Economic Council (NEC). The federal and provincial governments will have to formulate their budgets within the parameters approved by the NEC. Sanctions should be put in place for violations, breaches, and deviations. However, the provinces should be allowed to exceed the NEC-approved parameters if they raise additional revenues from their own sources.

Second, a new fiscal responsibility law should be enacted by each province in which the limits for fiscal deficit/surplus, revenue mobilisation, and expenditure on development should be imposed. If the allocation for the provinces from the divisible pool rises or provinces make an extra tax effort, the incremental resources should be earmarked for development projects or for education and health. Provinces have to generate budgetary surpluses in order to offset the deficit of the federal government.

Third, the provincial governments should not be allowed powers to borrow from the domestic capital markets or financial institutions. Foreign loans for development projects and foreign grants should be channeled through the federal government and conform to the NEC-approved national plan and annual budget. The advances of the SBP should be strictly used for smoothing cash flow problems rather than as additional financing for the budget or non-budget expenditure.

Fourth, responsibilities for education up to matric, primary healthcare, rural health centers, tehsil and district hospitals, drinking water, sanitation and sewerage, agriculture, and community development should reside at the district level and should be administered by the elected local governments. The provincial finance commissions should be revived to divide the revenues between the provincial and district governments. Backward districts and rural areas should be given higher weightage in the allocation of resources.

Fifth, education, health, police, and the judiciary should be taken out of the purview of the national pay scales as they have created rigidities and distortions and reinforced income disparities between the advanced and backward districts. A female science teacher employed at Mithi or Kandhkot should earn a higher salary than the one in Karachi or Hyderabad. Similarly, doctors, nurses, and paramedics serving in remote and inaccessible areas deserve much higher compensation than those living in cities.

Sixth, tax effort by the provinces has slackened after the 7th NFC Award. Incentives have to be built in the 8th NFC Award by giving weightage to the tax effort by the provinces. Urban immovable property tax, agriculture income tax, abiana, and GST on services are some very obvious avenues for additional revenue mobilisation by the provinces. Rough estimates show that, if designed properly and implemented faithfully, the provinces can raise at least two per cent of the GDP.

International experience has shown that if fiscal federalism is not tackled in a responsible manner, it can create serious economic dislocations and disruptions. Argentina and Brazil had suffered from hyperinflation due to the fiscal profligacy of state governments. The institutional and legal arrangements had to be redrawn to overcome this problem and since then checks and balances have worked well. China had to rework the federation-province tax arrangements, which have now provided adequate fiscal space to the federal government. Presently, Spain is facing the consequences of fiscal excesses of strong regional governments. Domestic and international markets are punishing Spain by either withholding credit or raising the price of credit to levels that may make Spain insolvent. We may be at the beginning of the path towards a similar precipice and ought to take preventive measures at this stage and retreat from this dangerous path.

Source: Husain, Ishrat, The New Fiscal Federalism, *The News*, Karachi, 25 June 2012

Box 13.2

A New Fiscal Order

Sakib Sherani analyses the implications of the 7th NFC Award.

The seventh NFC Award and the passage of the 18th Amendment have furthered provincial autonomy and the process of devolution to an unprecedented degree.

However, in meeting the spirit of the 1973 constitution, these two seismic developments have added a layer of complexity and challenge to both the governance and fiscal framework of the federation.

On paper, the envisaged quantum increase in the transfer of resources to the provinces under the seventh NFC Award, nearly doubling in size, with stepped-up increases to follow in later years, was to be financed from two sources: the introduction of an integrated (i.e. with goods and services in its ambit) and centrally collected value added tax (VAT) and the transfer of expenditure obligations from the federal budget to the provinces in line with the process of devolution of functions. The latter, however, was to occur after a lapse of one year to allow provinces to prepare, leaving the federal budget under considerable strain during the interim period.

In practice, the transfers under the NFC Award have kicked in without the launch of an integrated VAT (or any successor arrangement such as Reformed General Sales Tax, or even any meaningful fiscal effort by provinces), and devolved functions have been nominally transferred to the provinces without the expenditure obligations. Hence, instead of expenditures totalling Rs. 187bn that were to be transferred to provinces under the devolution exercise (the original calculation worked out at the time of NFC deliberations in 2009), according to the Ministry of Finance, provinces have agreed to take on only Rs. 5bn to Rs. 6bn on to their budgets for 2011–12. This leaves the federal budget to cope with an additional fiscal burden of some 2.7 per cent of GDP at a time when it is trying to bring some sanity to the fiscal framework.

The combination of a lack of overall fiscal effort to meet the increased resource transfers, and the lack of preparation and enhancement of capacity by the provinces to take on the expenditures as well as functions relating to devolved subjects, unless managed properly, is a potential source of a permanent 'structural' fiscal deficit.

Of equally great concern, however, is the potential impact on service delivery. With provinces unwilling to finance key devolved functions such as education and health services, for example, and the federal budget unable to do so with its current constraints, the whole purpose of devolution could be defeated by the potential for near-collapse of service delivery to the common citizen. At its most basic level, for example, the Rabbani commission does not appear to have taken into consideration the need for physical working facilities and provision of housing for the thousands of employees required to staff the devolved functions in the provinces.

Hence, in addition to an existential threat from the lack of fiscal effort, the whole devolution exercise suffered from a fundamental weakness in the formulation stage: the overlooking of the state of provincial capacities to absorb the additional resources in a transparent and well-directed manner, and the absence of a road map on how to build those capacities before functions are transferred.

The critical issue now is how the country's overall fiscal situation post-NFC and the 18th Amendment can be salvaged, and how the overall fiscal framework can be placed on a structurally sounder footing in the post-devolution environment. A number of recommendations to this end:

The 'architecture' of fiscal planning in the country needs to change fundamentally in the light of the 18th Amendment.

Essentially, five different government budgets (one centre plus four provincial) need to be synchronised more than ever before to yield one consolidated, workable overall fiscal framework. This should be done at the level of the Council of Common Interests (CCI), as propounded by Dr Ishrat Husain.

Once the CCI has endorsed the framework, any provincial surplus targets would become binding on the provinces. Failure to do this prior to the formulation of the 2011–12 federal and provincial budgets has resulted in the disconnect between the finance ministry where it programmed a consolidated budget surplus by the provinces equal to 0.7 per cent of GDP while the individual budgets of the provinces yielded a deficit.

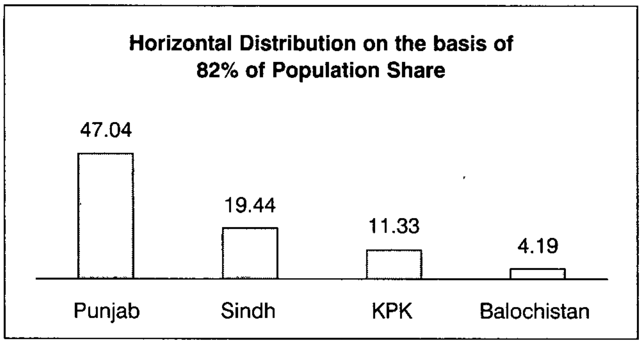
In the interim, the federal and provincial governments may need to consider a standstill agreement to be applied to the NFC transfers. This is important since servicing the fiscal transfers to the provinces was contingent on additional resource mobilisation. While the introduction of VAT was explicitly discussed in the NFC deliberations as a prerequisite for the framework to be viable, it was not made a formal, binding part of the NFC agreement. This was a mistake. However, contrary to popular perception, the provinces had lived up to their commitment on the issue till the shenanigans of two top federal bureaucrats unravelled the trust deficit built on the back of the NFC Award, and by default, made the integrated VAT unworkable, at least for Sindh.

Where the provinces have not lived up to their expectations is in the level of their own fiscal effort. With virtually most large tax bases domiciled in the provincial domain (such as agriculture, real estate and services), for tax collection by provinces to total an abysmal 0.5 per cent of GDP is untenable. Without a minimum threshold of provincial fiscal effort, the NFC transfers should be held in abeyance till certain benchmarks are achieved. The 'trigger' for NFC transfers to resume could be, for example, achievement of tax collection equal to one per cent of GDP by the provinces.

Finally, since the provinces will be able to borrow commercially after the passage of the 18th Amendment, it may become necessary to have provincial legislatures pass their own Fiscal Responsibility and Debt Limitation laws to establish the overall debt ceiling.

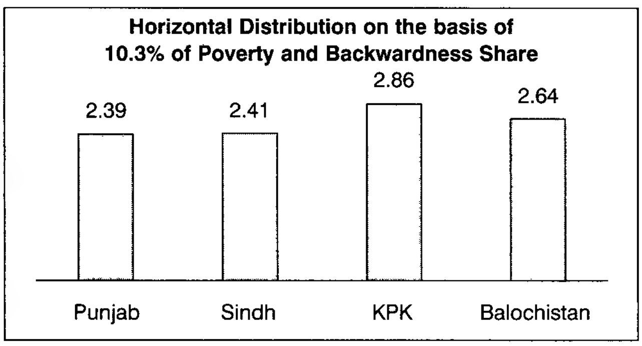
Source: http://www.columnspk.com/2011/07/15/a-new-fiscal-order-by-sakib-sherani/ Accessed 3 July 2013.

Graph 13.1: Weightage of Population in the NFC 2010



Source: Based on NFC 2010 Award Distribution.

Graph 13.2: Poverty and Backwardness



Source: Based on NFC 2010 Award Distribution.

Table 13.15
Incidence of Poverty in Pakistan

Year		Population in million		per cent of Total Population
		Total	Below Poverty line	
August	1947	35	21	60
October	1958	44	26	59
March	1969	56	22	40
July	1977	72	28	39
August	1988	97	16	17
October	1999	131	47	36

Source: Data compiled and tabulated from Burki, Shahid Javed, *Changing Perceptions and Altered Reality* (Karachi: Oxford University Press, 2005), 1–63.

13.3.2 Poverty or Backwardness Criteria

Like many other developing countries, Pakistan has been suffering from poverty, unemployment, and inflation. Being a poor country the NFC 2010 Award laid down 10.3 per cent of the total divisible pool to be distributed on the criterion of poverty and backwardness. For targeting poverty, the federal and provincial governments need to have fair and reliable statistics on the poverty profile. The percentage of total population living below the line of poverty (see Table 13.15) after independence has declined considerably, by almost 10 per cent in 1969 and then by a greater magnitude of 23 per cent up to 1998. The situation started worsening with poverty rising from 17 per cent to 36 per cent in eleven years. This kind of volatility is a major concern when preparing development policies.

Not only does the incidence of poverty vary across the federating units of Pakistan, but within the provinces variance in urban and rural poverty and incidence in large and small cities is substantially high. As Table 13.16 shows, the overall position of Pakistan, Punjab, and Sindh is almost the same, i.e. 36.79 per cent, 35 per cent, and 36.27 per cent, respectively. Furthermore, the two less, developed provinces KPK and Balochistan are at 41.71 per cent and 45.68 per cent. Lifestyle, standards of living, baskets of consumptions and every other parameter is distinguished between the urban and rural areas. Therefore, it is imperative to study the nature, resulting problems, and countering strategies for urban and rural poverty, separately. As a whole, Punjab, KPK, and Balochistan reflect 0.44 per cent, 8.67 per cent, and 3.05 per cent (see Table 13.16) lower incidence of poverty in rural areas compared to urban areas. However, variance amongst the large and small cities is simply not comparable.

Equalizing federal transfers to the provincial or sub-national governments is primarily of a redistributive nature and is meant to provide public goods to achieve the objectives of reducing poverty, inter- and intra-regional disparities, and providing social sector development generally. Sometimes, targeted conditional matching grants are also provided for such objectives. Estimating the level of poverty and designing the framework of fiscal transfers accordingly, is the need of the time. As Graph 13.2 shows, the average poverty in all of the provinces is almost at the same level, which is clearly not the case as much research shows. The NFC Award should have taken into account the conceptual segregation between rural and urban poverty and then, per capita equalization matching grants for poverty reduction should have been sanctioned accordingly.

13.3.3 Revenue Collection and Generation Criteria

Modern states are presumed to have an inbuilt responsibility for the welfare of their citizens. Redistribution of income and wealth have always been for important moral and economic justice. It is a common problem in most of the developing nations that revenues are lower than expenditures, accounting for fiscal deficits, as is the case of Pakistan.

Provision of public goods by provinces is mainly dependent on federal transfers in Pakistan. It is argued that a good transfer system ought to take account of the fiscal capacity to generate own-source revenue and reward fiscal effort proportionately. The present arrangement arrived at accounts for revenue generation and revenue collection of up to 5 per cent, which is a weak incentive for those provinces which have substantial economic activity and revenue generation and collection. Out of the 5 per cent share in revenue collection and generation, 2.5 per cent is for Sindh, Punjab's share is 2.2 per cent, while KPK and Balochistan are 0.25 per

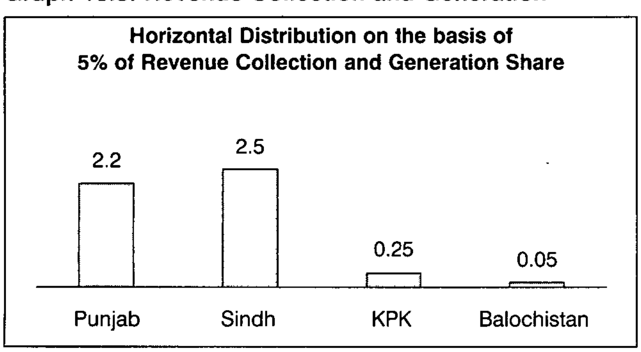
Table 13.16
Predicted Poverty Incidence: 2010–11

Pakistan and its Federating Units	Percentage of Population below the Poverty Line						
	Overall	Regions					
		Urban Areas			Difference between large and small cities*	Rural Areas	Difference between Urban and Rural*
		Overall	Large Cities	Small Cities			
Pakistan	36.79	35.75	26.41	47.88	21.47	37.31	1.56
Punjab	35.00	35.30	27.60	43.44	15.84	34.86	–0.44
Sindh	36.27	32.36	23.07	54.96	31.89	39.92	7.56
Khyber PakhtunKhwa	41.71	48.90	45.20	50.97	5.77	40.23	–8.67
Balochistan	45.68	48.00	25.18	62.26	37.08	44.95	–3.05

*Calculation added by the author
Source: Jamal, Haroon, 'Predicting Sub National Poverty Incidence for Pakistan', *Research Report* 85 (Karachi: SPDC, May 2013).

cent and 0.05 per cent, respectively—see Graph 13.3. We will now discuss the revenue collection statistics of the federating units of Pakistan, and the major contribution sources of revenue to the system.

Graph 13.3: Revenue Collection and Generation



Source: Based on NFC 2010 Award Distribution.

13.3.4 Tax Collection and Distribution across Federating Units of Pakistan

On average, the two developed provinces of Pakistan, Sindh and Punjab, make a significant contribution amounting to 96.35 per cent of the tax collection and generation, while the contribution of the two less-developed provinces, KPK and Balochistan, is 3.65 per cent on average for 2001–12. Table 13.17 shows the dominance of Sindh over the other provinces, but this is strictly not comparable due to its monopoly over port resources which facilitates superiority in collection of indirect taxes such as custom sales tax, and FED on imports. The average 2001–12 share of Sindh was 65.44 per cent, followed by Punjab at 29.84 per cent, KPKs at 3.38 per cent, and Balochistan at 1.34 per cent, with a maximum of 71.78 per cent, 34.91 per cent, 5.42 per cent, and 2.07 per cent for each of the provinces during 2001–12. In the NFC Award 2006, Sindh's argument was based on its capacity of revenue collection and generation which had no competitor. However, due to an absence of consensus, no Award was announced, and instead the President issued a revenue order.

Karachi ranks on top on the basis of average overall tax collection in the past twelve years, with an average of 62.7 per cent, followed by Lahore at 13.63 per cent, Rawalpindi at 8.33 per cent, Multan at 5.50 per cent, and Peshawar at 3.19 per cent; the rest of the ten cities (Hyderabad, Quetta, Faisalabad, Gujranwala, Abbottabad, Sialkot, Sukkur, Sargodha, and Bahawalpur) individually lie below 3 per cent and jointly account for 7.28 per cent of the overall tax collection. The situation is quite obvious and often exploited for political mileage for Karachi to be awarded provincial status or greater fiscal autonomy—see Chapter 23. As a whole, the average collection of taxes in Sindh over the last twelve years, 2001–12, shows 95.83 per cent collection from Karachi and 2.09 per cent and 2.08 per cent from Hyderabad and Sukkur.

More recently in 2011–12 the joint share of the top five cities (Karachi, Lahore, Rawalpindi, Multan, and Peshawar) accumulated to 92.08 per cent and the next ten cities' share just 7.92 per cent. We will now discuss the components of tax collection in detail. The overall taxes are broadly classified into two categories, direct and indirect taxes. Direct taxes include Income and Corporation Tax, Withholding Tax, Workers' Welfare Fund (WWF), Workers' Profit Participation Fund (WPPF), Capital Value Tax (CVT), and Corporate Asset Tax (CAT). The 18th Amendment to the Constitution has devolved CVT on immovable properties to the provinces. Indirect taxes include custom duties, sales tax on domestic and imports, and FED on domestic and imports. Pakistan's taxation structure is highly dependent on indirect taxes.

The average position of provinces in direct tax collection is almost the same, with Sindh being the highest with 64.97 per cent, Punjab with 30.93 per cent, KPK with 3.24 per cent, and Balochistan with 0.86 per cent. Karachi dominates with an average 61.49 per cent, followed by Lahore, Rawalpindi, Multan and Peshawar with 17.33 per cent, 4.30 per cent,

Table 13.17
Province-wise Percentage Revenue Collections: Trend Analysis

Rank*	Provinces	2000–01	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10	2010–11	2011–12	Average	MAX	MIN
1st	Sindh	62.39	62.15	63.22	63.6	62.18	62.03	61.17	65.95	69.15	71.78	71.54	70.17	65.44	71.78	61.17
2nd	Punjab	30.34	30.47	30.71	30.58	32.26	33.78	34.91	30.56	27.49	25.17	25.59	26.18	29.84	34.91	25.17
3rd	KPK	5.42	5.32	4.57	4.28	4.13	3.13	2.82	2.52	2.44	2.19	1.88	1.88	3.38	5.42	1.88
4th	Balochistan	1.84	2.07	1.5	1.54	1.43	1.06	1.11	0.97	0.91	0.86	0.99	1.76	1.34	2.07	0.86

*Rank of provinces based on average (2001–12) total tax collection in descending order (i.e. from highest in to the lowest in vertical columns).
Source: Author's calculation from the data of Federal Board of Revenue Year Book (Islamabad: various issues).

3.65 per cent, and 3.03 per cent, respectively. Indirect tax collection statistics are almost the same as for direct taxes, with Karachi dominating with an average 62.79 per cent, followed by Lahore, Rawalpindi, Multan, and Peshawar. Sindh's absolute advantage due to its monopoly over port resources can be observed in custom duty collection from a minimum of 78.92 per cent in 2007/08 to a maximum of 94.73 per cent in 2001/02. On average, 2001–12 Sindh's share in collection of custom was 84.21 per cent, followed by Punjab with 12.43 per cent, KPK with 2.31 per cent, and Balochistan with 1.05 per cent

For sales tax collection on domestically produced goods, Punjab has been contributing more than half of the sales with a percentage share of 55.5 per cent followed by Sindh with 40.20 per cent, and KPK and Balochistan with 2.91 per cent and 1.57 per cent. Karachi's average 2001–12 share was 35.63 per cent followed by Rawalpindi 's 23.49 per cent, Lahore's 19.58 per cent and Multan's 10.19 per cent, where these four cities account for 88.89 per cent collection with the remaining larger cities contributing individually below 5 per cent and jointly 11.11 per cent.

These patterns are reflected in other taxes as well. Although Sindh enjoys the largest share of the pie on account of revenue generation and collection, which is evident from the case presented above, the argument is that rewarding fiscal effort to an extent of five per cent and poverty and backwardness to almost more than double, i.e. 10.3 per cent, seems unfair and unjust and is a big incentive for not broadening the tax base and raising own-source revenue by sub-national governments in Pakistan. Therefore, rewarding fiscal effort should be linked to the per capita fiscal capacity of the province, rather than taking into account revenue collection and generation only. Consider the example of India—see Table 13.18—where the tax effort has been rewarded to 10 per cent in the 10th Finance Commission (1995–00) and 7.5 per cent in the 11th (2000–05) and 12th (2005–10). More recently, in the 13th (2010–15) Finance Commission Award, the tax effort has been abolished and the weight for fiscal discipline increased from 7.5 per cent to 17.5 per cent, which we advocate in the NFC criteria for Pakistan.

Provincial budgets are dependent on federal government transfers, and the way out is to increase the investment share in sub-national and national income apart from raising the tax-GDP ratio.

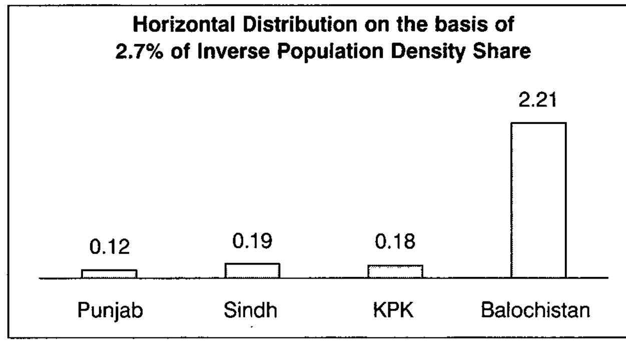
13.3.5 Inverse Population Density Criteria

One of the important features of development planning is to take care of the area in which government desires to intervene. In a technical sense, the dynamics of an area, its population, population density, i.e. persons living per square kilometres area and the needs of the people, and how much it costs for the government to create per capita provision of public goods, all matter. In a place where the population density is high, the provision of public goods per capita will be more practical and useful for a larger number of people. However, a province like Balochistan where the distance from one city to the next and one village to the other is very high, providing public goods and services and maintaining

them would cost very much and in turn may not deliver the same results as in dense areas. This does not mean that high population density areas have no problems for public service delivery, and in Karachi or Lahore establishing an efficient traffic network system is an extremely difficult task.

As Table 13.19 shows, the population density of Balochistan is the lowest amongst all the provinces with 27 persons per square kilometre, compared to Punjab (488), Sindh (313), and KPK (333). There is no comparison of Balochistan with the rest of the provinces; therefore, to compensate Balochistan the inclusion of an inverse population density criterion has been made part of the NFC 2010 Award—see Graph 13.4.

Graph 13.4: Inverse Population Density



Source: Based on NFC 2010 Award Distribution.

Table 13.18
Criteria for Horizontal Distribution of Divisible Pool under the Indian Finance Commission (IFC), (Distribution in per cent)

IFC	Period	Population	Collection/ Contribution	Inverse Per Capita Income	Backward-ness	Income Distance	Area	Index of Infrastructure	Tax Effort	Fiscal Discipline	Fiscal Capacity Distance
1st	1952–1957	80.0	20.0	–	–	–	–	–	–	–	–
2nd	1957–1962	90.0	10.0*	–	–	–	–	–	–	–	–
3rd	1962–1967	80.0	20.0	–	–	–	–	–	–	–	–
4th	1966–1969	90.0	10.0	–	–	–	–	–	–	–	–
5th	1969–1974	90.0	10.0	–	–	–	–	–	–	–	–
6th	1974–1979	90.0	10.0	–	–	–	–	–	–	–	–
7th	1979–1984	90.0	10.0	–	–	–	–	–	–	–	–
8th	1984–1989	25.0	10.0	25.00	–	45.0	–	–	–	–	–
9th	1989–1995	22.5	10.0	11.25	11.25	45.0	–	–	–	–	–
10th	1995–2000	20.0	–	–	–	60.0	5.00	5.0	10.0	–	–
11th	2000–2005	10.0	–	–	–	62.5	7.50	5.0	7.50	7.50	–
12th	2005–2010	25.0	–	–	–	50.0	10.0	–	7.50	7.50	–
13th	2010–2015	25.0	–	–	–	–	10.0	–	–	17.5	47.5

*Collection
The weight for inverse per capita income is calculated by multiplying the inverse per capita income by the population of the state.
Source: Table designed by author and statistics are compiled from reports of Indian Finance Commissions IFCs (1st–13th Finance Commission).

Table 13.19
Population Density by Provinces/Regions: 1951–1998 Censuses Data

Rank	Provinces	1951	1961	1972	1981	1998	2005*	2010*	2013*
		Persons/Sq. Km							
1st	Punjab	100	124	183	230	358	418	461	488
2nd	KPK	61	77	113	148	238	280	312	333
3rd	Sindh	43	59	92	81	117	260	293	313
4th	Balochistan	3	4	7	12	19	23	25	27
Total	**Pakistan**	**42**	**54**	**82**	**106**	**166**	**196**	**218**	**232**

Source: Computed from Population Census various issues.
*Computed from *Pakistan Economic Survey 2012–13* (Islamabad: Ministry of Finance, Government of Pakistan).

13.4 Some Issues Relating to Intergovernmental Fiscal Transfers and the NFC 2010 Award

13.4.1 Vertical Fiscal Imbalances

A fiscal imbalance is the mismatch between the revenue and expenditures of a government. The literature on fiscal federalism discusses two types of fiscal imbalances. Vertical fiscal imbalance is measured between two different levels (tiers) of government, i.e. national and sub-national, while horizontal fiscal imbalance is measured between the governments at the same level (tier).

Table 13.9 shows that vertical fiscal imbalance exhibits an almost consistent pattern over the period with the exception of the first Award after the fall of East Pakistan. The alarming situation is that the provincial share in revenues declined from a maximum of 14.2 per cent in 1972–75 to a minimum of 5.7 per cent which substantiates the argument of the substitution of federal transfers over own-source revenue efforts by sub-national governments in Pakistan. On the other side of the picture, the expenditure share of provincial government touched a maximum of 54.4 per cent and decreased over the period to a minimum of 25 per cent, although the situation is not very encouraging. The way out of this dilemma is to raise the provincial tax base and tax revenues.

13.4.2 Multiple Criteria and the Way Forward

The term 'multiple criteria' seems of some value; however, is this what the NFC is destined for? Will the notion of the present multiple criteria deliver? Does it need continuous objective assessment, monitoring, evaluation, and incorporating of any change, if needed? Is it flexible enough to integrate any other structural shift, if so desired, by the relatively less-developed provinces? Would the merits of reducing the overriding population share be considered by Punjab especially now when the PML–N has formed the new government in the federation and in Punjab? Would it be easy to consider other options for policy ambitions other than the present criteria? These are some of the questions we need to find the answer to in order to make a useful assessment.

Table 13.17 reflects the case of horizontal distribution of revenue between the Indian states. Up to the 7th Indian Finance Commission Award, the situation was almost uniform and the population criterion over-ruled the possibility of making a space for any other parameter. However, the post 8th IFC Award was the beginning of an evolutionary process in the history of Indian fiscal federalism. Income gape between rich and poor states was given consideration up to between 45.0 per cent and 62.5 per cent. Rather than considering the poverty statistics, such as head count, defining the poverty line, computing the average poverty of any state as a whole, the more useful measure of income distance was adapted. After the 10th (1995–2000) and 11th (2000–2005) National Finance Commission Awards of India, the average of the three richest states i.e. Goa, Punjab, and Maharashtra was taken to compute the income distance of other states, making the criterion more objective and screening out the possibility of the outlier value being selected, by taking average values.

As Table 13.20 shows, population is considered an important factor when looking for fiscal policy options therefore, it has been given adequate consideration by almost all the countries in horizontal revenue sharing formulae. It is important to note that Pakistan is on the top of the list when allocating share value against the population criterion.

The development gap criterion is like the income distance criterion of the Indian Finance Commission, the distance of sub-national governments in terms of development from the most developed sub-national government or the state.

Table 13.20
Criteria of Horizontal Distribution among Sub-National Governments

Country	Criteria	per cent
Argentina	Population	65.0
	Development gap	25.0
	Inverse population density	10.0
Brazil	Population	33.34
	Area	33.33
	Per capita income	33.33
Colombia	Population	70.0
	Equal Share	30.0
India 2010–2015	Population	25.0
	Area	10.0
	Fiscal discipline	17.5
	Fiscal capacity distance	45.5
Indonesia	Collection	100.0
Japan	Collection	100.0
Malaysia	Collection	100.0
Mexico	Population	50.0
	Collection	50.0
Nigeria 2008 (Commission is analysing options for revision in 2013.)	Equality	40.0
	Population	30.0
	Social development factor	10.0
	Education	4.0
	Health	3.0
	Water	3.0
	Landmass/Terrain	10.0
	Internal Revenue Effort	10.0
Pakistan 2011–2015	Population	82.0
	Poverty and backwardness	10.3
	Revenue collection and generation	05.0
	Inverse population density	2.70
Philippines	Population	70.0
	Land area	20.0
	Equal share	10.0

Source: *The Reform of Inter governmental Fiscal Relations in Developing and Emerging Market Economies*, World Bank, Policy and Research Series 23 (Washington DC: World Bank, 1994).

Pakistan has a long way to go to break the ice further. A rationalized transfers system would definitely create distributive efficiency and allocative efficiency, apart from achieving the objective of fiscal equalization.

13.4.3 Sales Tax and Provinces

Prior to the approval of the 7th NFC, the federal government was collecting the sales tax, although the Constitution of 1973 specified it to be the responsibility of the provinces—see Chapter 10. The sales tax has been recognized as a provincial subject and provinces have been given legal authority to collect it. It has been argued[13] that the provinces lack the ability to implement any kind of crediting and refund mechanism in respect of the general sales tax (GST) on services. Further claims and adjustments on intra-provincial transactions need to be addressed via mechanisms which still need to be established. The assignment of the general sales tax on services is not explicitly operational during the lifetime of the current Award however, the revenue sharing arrangements were based on the assumption of additional revenues on account of GST on services collected by the provinces.

Ehtisham Ahmed[14] discusses the policy options to be considered for GST and argues that GST should be given entry to the divisible pool for reasons of efficiency and better performance. The second option that he advocates is the Australian model that GST should be collected by the federal government and returned back to the provinces under the equalization grants system. The third is the Chinese model where the richer provinces may come forward to meet the equalization objective and share the GST with provinces with lower volume of transactions and lower revenue generation capacity under GST.

13.4.4 Substitution of Fiscal Effort by Sub-National Governments

Revenue collection by the federal government comprises 93 per cent of total tax collection whereas almost 6 per cent and 1 per cent revenue is collected by the provincial and local governments, respectively. One of the most persistent problems in the history of fiscal federalism and tax administration in Pakistan is that provincial governments create provision of public goods by employing of resources acquired through federal transfers. *The provincial governments as a whole substitute federal transfers for their own fiscal effort and do not tax their residents.* Although this act of fungibility (substitution of federal transfers for own fiscal effort) may lead sub-national governments to a greater political advantage and benefit in terms of gaining votes in electoral politics, at the same time this gives rise to fiscal indiscipline. As Table 13.18 shows, fiscal discipline is an important feature of the Indian horizontal distribution formula assigning a weightage of 7.5 per cent in the 11th and 12th Awards, and 17.5 per cent more recently in the 13th Award. Rewarding on the basis of fiscal discipline, restricts provincial/sub-national governments from incurring high budget deficits and borrowing which in turn promotes optimized allocation of national resources. Although in the case of Pakistan the reward assigned to such discipline may not fetch the desired results in the short run however, this parameter can be a useful one in maintaining checks and balances on provincial expenditures, especially when the higher amount of resources are devoted for provinces in vertical sharing (see Table 13.8) and abolishment of the concurrent list leading to devolution of more functional assignments to the provinces, especially after the 18th Amendment. The Pakistan Fiscal Policy Statement 2010/11, warns the provincial governments as follows:

> The goal of fiscal decentralization envisioned under the 7th NFC Award cannot be achieved in true spirit unless the provinces exercise fiscal discipline and maturity in their economic management. Without effective management of the resources, the requisite fiscal space cannot be reached that is necessary for investments in social, economic, and industrial sectors. In this context, the provincial governments in Pakistan are required to employ additional resources in an efficient and optimal way. The provincial governments are also expected to reduce their excessive dependence on federal transfers and mobilize their own resources as there is wide room available to them to revise the tax lists and enhance their revenue base.[15]

The 13th Finance Commission of India is characterized by the inclusion of a new parameter in the horizontal distribution criteria, i.e. fiscal capacity distance. The report on 13th IFC defines fiscal distance as the 'distance of a state's estimated per capita revenue from the estimated per capita revenue of Haryana, thereby reached at per capita entitlement and after multiplying the figure with population of the state the share of state is arrived at'. This criterion may not work for Pakistan because per capita revenue from Sindh will have the highest value and Punjab may be close to Sindh when comparing nominal figures; however, in per capita terms it will lie far behind Sindh. It is difficult to compare the per capita revenue of KPK and Balochistan with that of the highest one and then computing the shares for the purpose of the equalization objective.

13.4.5 Conditional versus Unconditional Grants

The conditionality annexed with grants is debated extensively in purview of being at the cost of provincial autonomy. On the other hand, unconditional grants ensure higher level of discretion to be exercised by the provincial government. In the case of Pakistan, performance-based conditional grants should be encouraged, since these would help the federal government to contain the provincial revenue deficits. The Medium Term Budgetary Framework of the Government of Sindh has also adopted the same methodology instead of providing grants on the conventional incremental basis. The targeted performance indicators are set as the barometer of performance for continuance of grants.

Usman Mustufa[16] suggests that fiscal equalization needs to be focused on for various grant programmes which balance the per capita fiscal capacity for which scientific calculations are required for financial ability equalization. This can be achieved easily by commissioners in the tax system, and is a straight forward and less rigorous data exercise.

13.4.6 Fiscal Federalism and Poverty Reduction

One outcome of intergovernmental fiscal transfers is meant the creation of horizontal fiscal equalization and in reducing inter-regional disparities. The argument of advocating a more rational regime of fiscal federalism sounds more important if poverty reduction through effective provision of pubic goods is a goal. A criterion where provinces are given representation just on the basis of population may not be able to work as well where there are multiple issues such as those in the structure of fiscal federalism in Pakistan. What if greater sub-national autonomy is awarded, as it has been done under the 18th Amendment and in the NFC Award 2010, and poverty does not fall? Below, we present the case for horizontal fiscal equalization which aims to analyse different Awards as well as the nature of grants and their impact on horizontal fiscal equalization.

13.5 The Case of Fiscal Equalization

Hafiz Pasha and his colleagues[17] analysing the relative per capita federal transfers—see Table 13.21 and 13.22—have shown that the magnitude of federal transfers to the Punjab has always been lower than its relative share in the population, while the case of Sindh appears to be the reverse.

The trend for Khyber Pakhtunkhwa is more variable, while the accruals of federal transfers to Balochistan have been in a higher proportion compared to its relative population. Per capita transfers to the smaller and less-developed provinces are high compared to those of large and relatively developed provinces, which means that the Award manages to compensate the smaller and less-developed provinces. The structural change in the design of criteria-based transfers brought about positive developments, such that the divisible pool started to equalize resources between provinces. Relatively less-developed provinces were better off in terms of receiving a higher share of the pie. Divisible pool transfers, total transfers, and special grants as a whole, with the exception of straight transfers, have an equalizing effect in the present Award. (See Tables 13.22 and 13.23)

13.5.1 Fiscal Equalization Index (FEI)

In our case the concentration index is used to calculate whether the NFC divisible pool transfers, straight transfers,

Table 13.21
Federal Transfers to the Provinces

	1990–91	1991–92	1996–97	1997–98	2005–06	2007–08	2009–10	2010–11
Federal Transfers To The Provinces	Rs. in Billion							
	33.8	65.8	139.4	131.7	316.0	506.7	718.3	1,068.7
	per cent							
Punjab	55.3	45.1	51.3	47.0	47.1	47.3	47.2	46.7
Sindh	24.0	23.9	24.9	23.8	30.1	29.8	29.3	26.7
KPK	12.7	19.0	15.9	17.8	14.4	14.8	15.2	17.1
Balochistan	7.9	12.0	7.9	11.4	8.4	8.0	8.3	9.5
Pakistan	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Pasha, Hafiz et al. *Fiscal Equalization among Provinces in NFC Awards* (Lahore: BNU, Institute of Public Policy, 2010).

Table 13.22
Relative Per Capita Transfer by Province

Province	1990–91	1991–92	1996–97	1997–98	2005–06	2007–08	2009–10	2010–11
Punjab	0.953	0.778	0.884	0.810	0.821	0.824	0.822	0.815
Sindh	1.030	1.026	1.069	1.021	1.270	1.257	1.235	1.127
KPK	0.948	1.418	1.186	1.328	1.043	1.072	1.099	1.234
Balochistan	1.453	2.264	1.491	2.151	1.647	1.569	1.565	1.857
Pakistan	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**	**1.000**

$$\text{*Relative Per Capita Transfers} = \frac{\text{per cent Share in Federal Transfers}}{\text{per cent Share in Population}}$$

Source: Pasha, Hafiz et al. *Fiscal Equalization among Provinces in NFC Awards* (Lahore: BNU, Institute of Public Policy, 2010).

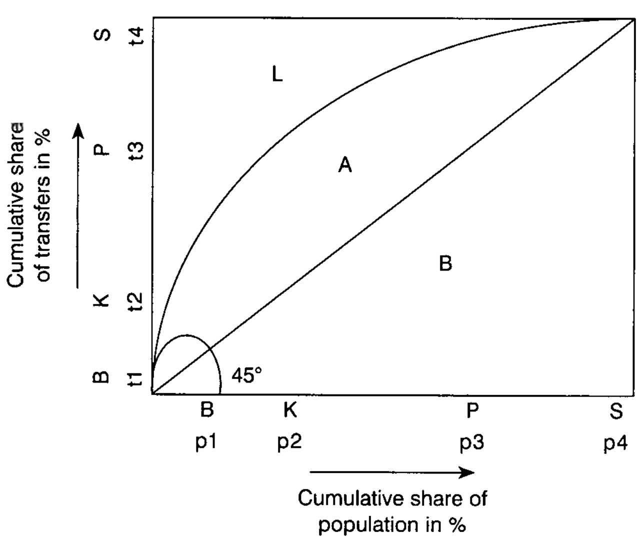
Table 13.23
How Intergovernmental Fiscal Transfers have been Equalizing in Pakistan?

NFC	Divisible Pool Transfers	Straight Transfers	Special Grants	Total Transfers
NFC 1991	Neutral	Yes	No	Yes
NFC 1996	Neutral	Yes	Yes	Yes
NFC 2006	No	No	No	No
NFC 2010	Yes	No	Yes	Yes

Source: Institute of Public Policy, *State of the Economy Devolution in Pakistan, Annual Report 2011* (Lahore: BNU, Institute of Public Policy, 2010).

development grants, and non–development grants are concentrated in the relatively developed Sindh and Punjab or in underdeveloped KPK and Balochistan. The negative magnitude of the index refers to equalization and the positive, to the inverse.

Figure 13.1: Lorenz Curve



Source: Figure designed by author

The concentration index is defined with reference to the concentration curve (PT), which graphs on the x-axis the cumulative percentage of the sample ranked by living standards, and beginning with the poorest; on the y-axis, the cumulative percentage of the NFC transfers variable corresponding to each cumulative percentage of the distribution of the living standard variable is shown.

$$FEI = (p_1 t_2 - p_2 t_1) + (p_2 t_3 - p_3 t_2) + \dots + (p_{n-1} t_n - p_n t_{n-1})$$

Stands where p stands for cumulative population share and t stands for cumulative share of provinces in transfers. The concentration index is defined as twice the area between the concentration curve, $L(P)$, and the line of equality (the line running from the bottom-left corner to the top-right). So, in the case where there is no income-related inequality, the concentration index is zero. The convention is that the index takes a negative value when the curve lies above the line of equality, indicating disproportionate concentration of the NFC transfers variable among the poor, and a positive value when it lies below the line of equality. The negative FEI means that the federal transfers to provinces are accruing to relatively poor provinces and positive FEI means the contrary. To set the order in which the provinces are to be placed on the x axis, the development rankings of provinces as discussed by Hafiz Pasha and his colleagues[18] (see Table 13.24) are taken into consideration for the purpose of computing a Fiscal Equalization Index using the idea of determining concentration by means of coordinate geometry. The percentages of population shares for the purpose of calculating the Fiscal Equalization Index with respect to the divisible pool transfers are taken from NFC reports and population censuses. We are computing the Fiscal Equalization Index by adopting development ranking for the data to be placed in defined order on the x–axis and y–axis. The order that is followed in Figure 13.1 is Balochistan, KPK,

Table 13.24
Development Rankings of Provinces

For development of the FEI, we need the ranking of provinces in terms of level of development. Sindh appears as the most developed province in almost all development indicators, with the exception of Human Development Index [HDI]. Also KPK and Balochistan interchange to occupy the third and the fourth rank in the development indicators. Therefore, the ranking of provinces in ascending order of development is Balochistan, KPK, Punjab and Sindh.

		Development Ranking of Provinces			
Indicator(s)		Punjab	Sindh	KPK	Balochistan
Average Household Income	1	II	I	IV	III
Per Capita GDP	2	II	I	III	IV
Human Development Index	3	I	II	III	IV
Deprivation Index	4	II	I	IV	III
Incidence of Poverty	5	II	I	IV	III
Vulnerability	6	II	I	III	IV

1. According to Household Income and Expenditure
2. According to Bengali [2003]
3. According to Hussain [2003] and Jamal [2007]
4. According to Jamal [2007]
5. According to Asian Development Bank [2003]
6. According to Jamal [2007]

Source: Pasha, Hafiz A et al. Fiscal Equalization in NFC Awards (Lahore: BNU, Institute of Public Policy, 2010).

Punjab, and Sindh, from least developed to most developed, and the FEI is hence calculated.

As Table 13.25 shows, the average Fiscal Equalization Index for the divisible pool transfers have been neutral throughout and disequalizing to some extent in the 2006 Award. It is imperative to note that after the inclusion of various parameters to adapt multiple criteria, the divisible pool transfers have started equalizing.

The overall average from 1973–2014 reveals that straight transfers are benefiting smaller provinces. The last two Awards (the most developed as per development ranking), have been disequalizing due to the concentration of the high share to Sindh. Sindh, on account of gas development surcharge, is presently enjoying a larger share in straight transfers. The average straight transfers during 2011–14 to Sindh are 59.50 per cent of the total followed KPK, Balochistan by and Punjab with respective shares of 19.52 per cent, 12.95 per cent, and 8.04 per cent—see Table 13.2.

Except for the 1998, 2006, and 2010 Awards, the magnitude of the concentration index has been over and above the average value individually for all Awards—see Table 13.25.

Table 13.26 shows that the average Fiscal Equalization Indices for non-development grants have performed better than the indices for development. Development and non-development grants have always been equalizing with the exception of the 1973–75 Award period FEI = +0.07 and 1992–97 Award period FEI = +0.25. To sum up, the total grants have been equalizing throughout, but now the magnitude of equalization is declining from a high of FEI = –0.35 in 1976–79 to a lowest of FEI = –0.04 in the 2007–10 Award. The total transfers including NFC transfers (divisible pool + straight transfers) and total grants (development plus non-development) have been equalizing but the extent of equalization is not encouraging, except in 1976–79 [FEI = –0.15) and 1980–83 [FEI = –0.12]; however, the total transfers in the 2007–10 Award (Revenue Order) have a neutral effect.

The higher magnitude of equalization of non-development grants compared to development may be due firstly, to the payment of arrears of hydro-electricity profits to KPK as non-development grants,[19] and secondly, to capital expenditures which are considered as developmental; hence, given that capital expenditure in the provinces is low, the volume of resources required for equalization is also low.[20]

Table 13.25
Average Fiscal Equalization Indices during NFC Awards post-1971

NFC Award Period	Divisible Pool	Straight Transfers*	Total NFC Transfers
1973–1975	0.00	–0.60	–0.07
1976–1979	0.00	–0.82	–0.07
1980–1983	0.00	–0.56	–0.06
1984–1991	0.00	–0.57	–0.04
1992–1997	0.00	–0.37	–0.08
1998–2006	0.00	–0.03	–0.01
2007–2010	0.02	0.24	0.03
2011–2014	–0.05	0.18	–0.05
Average 1973–2014	**0.00**	**–0.32**	**–0.04**

*will be referred in context of Concentration Index.
Source: Author's calculations.

Table 13.26
Average Fiscal Equalization Indices during NFC Awards post-1971

NFC Award Period	Development Grants	Non Development Grants	Total Grants	Total Transfers*
	For Development Ranking Figure–2			
1973–1975	0.07	–0.42	–0.14	–0.09
1976–1979	–0.07	–0.49	–0.35	–0.15
1980–1983	–0.10	–0.57	–0.30	–0.12
1984–1991	–0.03	–0.20	–0.16	–0.09
1992–1997	–0.07	0.25	0.05	–0.06
1998–2006	–0.14	–0.32	–0.27	–0.04
2007–2010	–0.14	–0.03	–0.04	0.00
Average 1973–2010	**–0.07**	**–0.25**	**–0.17**	**–0.08**

*Total NFC transfers plus Total Grants.
Source: Author's calculations.

13.5.2 Fiscal Equalization with the Dominance of Indirect Taxes and Distribution of Resources in Real Terms

Analysing the time-series of tax collection statistics during 1950–2012 reveals that the minimum proportion of direct taxes was 12.7 per cent in composition of tax collection in 1951 with a corresponding maximum of indirect taxes of 87.3 per cent. Furthermore, the maximum proportion of direct taxes was 39.6 per cent with a corresponding minimum of indirect taxes 60.4 per cent in 2010. The anatomy of behaviour of progressive and regressive taxation over the period—see Table 13.27—reveals that the tax structure has been transformed from greater reliance on indirect to direct taxation which is highly desirable since it is more equitable and just. Even now, the tax mix is fairly distant from a desirable one and focuses on indirect taxes whose incidence is regressive in nature.

The present Government of PML–N increased the rate of general sales tax from 16 per cent to 17 per cent in the budget of 2013/14 despite severe disagreement from opposition parties on the issue. The GST, obviously, is indirect and regressive in nature and would lead to inflationary pressure in general price levels in the country. Tax collection on higher prices will definitely generate higher amount of taxes increasing the size of the divisible pool to be redistributed. The point of argument is that an increase in GST may serve the said purpose, but at the cost of fiscal equalization; which means that in real terms the federal transfers to the

Table 13.27
Dynamics of Tax Mix

Fiscal Year	Direct Taxes	Indirect Taxes
1950/1	12.7	87.3
1960/1	23.0	77.0
1970/1	19.0	81.0
1980/1	20.7	79.3
1900/1	18.0	82.0
2000/1	31.8	68.2
2009/10	39.6	60.4
2010/11	38.7	61.3
2011/12	39.2	60.8
	Averages	
1951/71	21.5	78.5
1971/91	17.5	82.5
1991–2011	31.7	68.3
1951–2012	24.1	75.9
Maxima	39.6	87.3
Minima	12.7	60.4

Source: Calculated from Federal Board of Revenue Year Books Various Issues.

provinces will decline with the increase in cost-push inflation due to increase in regressive taxes, especially GST on goods. Therefore, social planners should take into account the real effect so that effective redistribution to the poor provinces and poor people of Pakistan may take place.

There has been a phenomenal change in the direct and indirect tax mix of India—see Table 13.28. Up to 1995 the situation was not encouraging and the mix reveals a ratio of 27.3 per cent versus 72.7 per cent dominance of indirect taxes. However, a look at the developments during the last decade and the present scenario reveal during that the mix has been optimally improved by 42.7 per cent versus 57.3. More recently the situation shows the supremacy of direct taxes over indirect ones. The resulting impact of this may be seen in the Indian economy emerging as one of the largest economies

Table 13.28
Composition of Tax Mix in Regional Countries

Years	India		Bangladesh	
	Direct Taxes	Indirect Taxes	Direct Taxes	Indirect Taxes
1974–75	22.4	77.6	11.8	88.2
1984–85	19.1	80.9	14.8	85.2
1994–95	27.3	72.7	15.9	84.1
2004–05	42.7	57.3	19.5	80.5
2009–10	59.5	40.5	28.1	71.9
2012–13	51.5	48.5	–	–

Source: Calculated from data of Handbook on Indian Economy published by Reserve Bank of India and Bangladesh Bureau of Statistics.

of the world and improving on the human development front as well. The position of Bangladesh although, has improved a lot yet the tax mix of direct and indirect taxes was 28.1 per cent to 71.9 per cent in 2010.

Agricultural taxation, although a very controversial and a politically charged issue in Pakistan, should now seriously be considered part of the agenda for future taxation reforms to be included in the divisible pool—see Chapter 5. The Constitution of Pakistan, 1973, clearly defines agricultural income as a provincial subject, but it has never been subject to taxation due to structured feudal dominance amongst elected representatives in the Parliament of the country. Apart from the fiscal policy issue, it is also a rather grave concern with regard to the political economy of Pakistan. Although agricultural tax is a provincial subject and the collected proceeds would not form part of the divisible pool, the reduction in the substitution effect of federal transfers over the own-source revenue effort by the provincial governments would clearly be observed in future. This course of action would also determine the spirit of the provincial revenue effort and reduce the substitution effect as discussed above—also see Box 13.1.

There is no escape for the economic managers of the country except to realize and implement a comprehensive future agenda of broadening the tax net, i.e. tax-to-GDP ratio, and reduce the burden of indirect taxes so that the effect of real fiscal transfers to the provinces become more positive.

13.6 The 18th Amendment: The Way Forward to Devolution?

The Constitution of 1973 restored parliamentary democracy in Pakistan through the two houses: the lower house; National Assembly and the upper house, the Senate. Article 160 of the Constitution is about the National Finance Commission similar to Articles 144 and 118 of the Constitutions of 1962 and 1956. However, the addition of Clause 3(A) of the 18th Amendment has guaranteed a share for the provinces not less than the share allocated to them in the previous Awards. Clause 3(B) directs the federal Finance Minister and provincial Finance Ministers to administer a post-implementation review of the Award and present the report to the National Assembly bi-annually.

Article 70(4) discusses the legislative powers of the Federal Government and the Fourth Schedule to the Constitution mentions the Federal Legislative List containing 67 subjects, 59 in Part I and 8 in Part II. The Concurrent List contained 47 subjects. Unanimously, at the time of the Constitutional Accord of 1972 it was verbally agreed by all political parties that the Concurrent List would be abolished after ten years of the Constitution and the subjects shall stand devolved however, this did not happen. The List was abolished in the 18th Amendment and 40 out of 47 subjects have been transferred to the provinces—see Figure 13.2.

Article 142 of the Constitution after the 18th Amendment gives Parliament the exclusive mandate for legislation in respect of the Federal Legislative List. The Federal Legislative List consists of two parts. Part I is the exclusive domain of

Figure 13.2: Legislative and Actual Functional Responsibilities Pre- and Post- 18th Amendment

Legislative Functional Allocation Pre 18th Amendment	Functions and Services	Actual Functional Allocation Pre 18th Amendment 1973–2010	Legislative and Actual Functional Allocation Post 18th Amendment
Federal Government	Defence External affairs Post and telegraph Telephones Radio and TV Currency Foreign exchange Foreign aid Institutes for research Nuclear energy Ports and aerodromes Shipping Air service Stock exchange National highway Geological surveys Censuses Meteorological surveys Railways Mineral oil and natural gas Industries	Federal Government	Federal Government
Federal / Provincial Government	Population planning Electricity (except KESC) Curriculum development Syllabus planning Centers of excellence Tourism Social welfare	Federal Government	Provincial / Local Government
Federal / Provincial Government	Vocational/Technical training Employment exchange Historical sites & monuments	Federal / Provincial Government	Provincial / Local Government
Provincial Government	Law & order Justice Highways Urban transport Secondary & higher education Agriculture extension Distribution of inputs Irrigation Land reclamation	Provincial Government	Provincial / Local Government
Local Government	Curative health Land development	Provincial Government	Provincial / Local Government
Local Government	Primary education Preventive health Farm–to–market roads Water supply, drainage and sewerage	Provincial / Local Government	Provincial / local Government
Local Government	Link roads Intra–urban roads Street lighting Solid waste management Fire fighting Parks, playgrounds	Local Government	Local Government

Source: Table designed by the author from the Constitution of Pakistan, 1973 as amended to date.

the Federal Government and Part II comes under shared responsibility. Matters pertaining to Part II are to be routed through the Council of Common Interest. See Figure 13.2 for the functions/subjects which the Federal Government had encroached upon, and over which the provinces were not exercising their exclusive jurisdiction. These are now exclusively provincial subjects. This Amendment has granted provinces maximum provincial autonomy, which is why the first day of the fiscal year proceeding the Amendment, 1 July 2011, was celebrated as the Provincial Autonomy Day.

The provinces have been granted greater fiscal powers by deleting the under-mentioned five items from the Federal Legislative List I: state lotteries, duties regarding succession of property, estate duty in respect to property, capital gains, and general sales tax on services.

By virtue of provisions embedded in the Constitution after the Eighteenth Amendment, residual subjects are meant to be provincial as is the case with the Government of India Act, 1935, and the Constitutions of 1956 and 1973. However, if the provinces' autonomy is not guaranteed and ensured, the possibility of jurisdictional conflicts between Federal and Provincial government does exist.

13.7 Summary and Further Reading

13.7.1 Summary

The analysis of fiscal and political federalism presented in this chapter may not be exhaustive; yet it explores most of the important dimensions, emerging dynamics, critical issues, and the agenda for reforms regarding federalism. Without doubt, the change is visible, although more on paper, and shows that there is still a long way to go. There are many important lessons in the story of federalism from pre-independence to the post-colonial era and further up the seventh National Finance Commission and Eighteenth Amendment to the Constitution of Pakistan, 1973. As Table 13.6 shows, four of the Awards remained inconclusive and the evolution of federalism recorded a history of ad-hocism. From the Raisman Award to the 1970 Award, the structure of horizontal sharing seems somehow consistent, based on population and sales tax on a pre-assigned share on the basis of collection, i.e. origin principle. Post the 1970 Award, horizontal sharing is based on the sole criterion of population which resulted in the over-dominance of the Punjab due to its huge share in the national population. This has caused a deep sense of deprivation amongst the less-developed provinces and has aggravated regional inequalities.

The eleven years from 1979 to 1991 is the non-Award period and adhoc arrangements were in place. Just after that, the 1991 Award was announced under a democratic regime and the practice of revenue deficits bridging grants was introduced for the sub-national governments, resulting in incentives for the provinces for non-rational spending and substitution of federal transfers for own-source revenue generation. The 2006 Award proposed an annual increase in the vertical share of provincial governments but could not manifest any change in the horizontal sharing criteria.

The democratic government after the general elections of 2008 aimed to address the constitutional chaos after the 17th Amendment and Legal Framework Orders. The 7th NFC and Aghaz-e-Huqooq-e-Balochistan package were in line with the government's resolve to reduce inter-regional disparities among the provinces. The 7th NFC introduced multiple criteria and Punjab was persuaded to sacrifice its share voluntarily which was distributed to the three provinces. The 18th Amendment resolved the long outstanding demand of provincial autonomy by the provinces. Many experts believed that these moves would radically increase the vertical fiscal imbalance although it is at the same level as before the 7th NFC—see Table 13.9.

Population was still an overriding consideration before the 7th NFC, or perhaps the Commission had been reluctant to go for any new protocol, such as altogether changing the criteria. The shares of provinces were calculated on the basis of the population of the 1998 census. The dynamics of population statistics are changing from census to census therefore, it is imperative to conduct the sixth census before the constitution of the 8th NFC. Taking into account the poverty and backwardness of the provinces, a share of 10.3 per cent has been allocated on the basis of average poverty. The Commission should have examined the shares of all the provinces which are nearly the same on the basis of average poverty because the shares of all the provinces are almost equal. As we have discussed, in the case of poverty in Pakistan, there is a conceptual separation between rural and urban poverty. The share from revenue collection and generation was 5 per cent, which seems less of an incentive for much revenue effort.

The reform agenda for the future should take into consideration experiences of other developing countries. A comprehensive formula based on principles of equity and efficiency, i.e. fiscal capacity distance, income distance, fiscal responsibility, and per capita fiscal equalization and performance-based conditional grants system may be worked upon. Continued economic and financial appraisal of the National Finance Commission Awards would bring further rationalization to the system of intergovernmental fiscal transfers in Pakistan.

The historical examination of legislative and actual functional assignments to various levels of governments in Pakistan reveals that the federal government has always dominated the two sub-national tiers. The subjects assigned to the the federal government are national in scope and the cost and benefits can be better managed by the federation. However, this does not mean that functional assignments for provinces be encroached upon by the federation. Since the provincial governments were not empowered, they have not had the opportunity or ability to develop this capacity. Further to our discussion on expenditure assignments, the local governments in Pakistan could not evolve as strong institutions. The only elections of local bodies which Pakistani federalism has experienced were under the umbrella of military regimes, such as the system of Basic Democracies, the Local Bodies system under Zia and, Musharraf's District Government—see Chapter 12. However, under Musharraf,

for the first time in the history of Pakistan, the third tier of government was granted much importance, as well as financial, administrative, and governance powers. The development expenditure of local governments in Pakistan increased substantially and even local governments in rural areas of the country managed to perform exceptionally well and showed fiscal responsibility by delivering effective and efficient public goods. With the fall of the Musharraf system, the local government system has been in complete abeyance, which does not bode well for devolution in Pakistan.

A key issue regarding the NFC Award and the 18th Amendment which will need to be addressed at some stage regards the need for provinces to increase their own resources for increasing expenditure on the social sectors on which they are expected to spend. At the moment, the provinces are happily reliant on transfers from the federal government, while the federal government grows broke. If provinces raised their own revenues, the federal government would have more resources for macroeconomic issues, rather than to bail out the provinces.

13.7.2. Further Readings

Since the 18th Amendment and the Seventh National Finance Commission Awards are more recent developments, there has been little research on this subject. However, this is going to be an area of much interest and concern over the next few years. Moreover, there are already some essential papers and publications which are essential reading.

See, for example, Anwar Shah, *Making Federalism Work—The 18th Constitutional Amendment*, World Bank Policy Paper Series on Pakistan PK 03/12 (Washington DC: World Bank, November 2012); Katherine Adeney, 'A Step Towards Inclusive Federalism in Pakistan? The Politics of the 18th Amendment', *Publius: The Journal of Federalism*, 2012; Aisha Ghaus-Pasha, 'Making Devolution Work in Pakistan', *The Lahore Journal of Economics* 17: SE, September 2012; Usman Mustafa, *Fiscal Federalism in Pakistan: The 7th National Finance Commission Award and Its Implications*, Pakistan Institute of Development Economics Working Paper # 73 (Islamabad: PIDE 2011); Aisha Ghous-Pasha, Hafiz A. Pasha and Zubair Asma, *Horizontal Equalization among the Provinces in the NFC Awards*, (Lahore: Institute of Public Policy, Becaonhouse National University, 2010); Social Policy and Development Centre (SPDC), *Social Development in Pakistan—Devolution and Social Development, Annual Review 2012* (Karachi: SPDC, 2012); and, Institute of Public Policy, *Fourth Annual Report: The State of the Economy—Devolution in Pakistan* (Lahore: Institute of Public Policy, Beaconhouse National University, 2011).

NOTES

1. Asim Bashir Khan, Sindh Board of Investment, Government of Sindh, Visiting Faculty, Shaheed Zulfikar Ali Bhutto Institute of Science and Technology, SZABIST and student of Institute of Business Administration, IBA, Karachi has contributed to this chapter. He has done all the research and most of the write-up, and my work has been limited to organizing and editing Asim's contribution. Asim would like to thank Professor D. K. Srivastava, Dean, Madras School of Economics, Chennai, India, for his intellectual input and support for this Chapter. The authorship of this Chapter should be clearly attributed to Khan, Asim Bashir, 'Fiscal Federalism in Pakistan: Emerging Dynamics, Issues and Prospects', (Chapter 13), in Zaidi, S Akbar, *Issues in Pakistan's Economy: A Political Economy Perspective 3rd edition* (Karachi: Oxford University Press, 2014).
2. The 7th NFC Award was approved by the President of Pakistan on 10 May 2010.
3. The Amendment was passed by National Assembly on 9 April 2010.
4. Islam, Noorul, *Making of a Nation, Bangladesh: An Economist's Tale* (Dhaka: University Press Limited, 2003).
5. Sir Otto Ernst Niemeyer (1883–1971) was financial controller at HM Treasury and a Director at the Bank of England.
6. 'The Advocate' North Western Tasmania's only Newspaper, Thursday September 19, 1935.
7. 'The Advocate' North Western Tasmania's only Newspaper Saturday 2 May 1936.
8. Chapter 3, Article 246(C) of the Constitution of Pakistan, 1973, lists the areas included in FATA as: tribal areas adjoining Peshawar district, tribal areas adjoining Kohat district, tribal areas adjoining Bannu district, tribal areas adjoining Lakki Marwat District, tribal areas adjoining Dera Ismail Khan district, tribal areas adjoining Tank District, Bajaur Agency, Orakzai Agency, Mohmand Agency, Khyber Agency, Kurram Agency, North Waziristan Agency, and South Waziristan Agency.
9. The Raisman Programme formally known as the Raisman Award was the succession of the ongoing programme of economic reforms in Pakistan announced by Prime Minister Liaquat Ali Khan. The then Secretary Finance, Sir Jeremy Raisman, was appointed to prepare the mechanism for distribution of divisible pool resources. The recommendations of the Raisman Award were applicable with effect from 1 April 1952. Later the Award was terminated by the Prime Minster and renamed as the National Finance Commission Award.
10. The individual federating units should be able to control some of its own resources as desired.
11. The One Unit policy was announced on 22 November 1954.
12. Gilgit-Baltistan was given the status of the fifth province of Pakistan vide 'Gilgit-Baltistan Empowerment and Self Governance Order, 2009' on 29 August 2009.
13. Ahmad, Ehtisham *The Political-Economy of Tax Reforms in Pakistan: The Ongoing Saga of the GST*, 2010 Asia Research Centre Working Paper # 33.
14. Ahmad, Ehtisham, 'Can the new Intergovernmental Work in Pakistan? Learning from China', in Amjad, Rashid, and Shahid Javed Burki, (eds.), *Pakistan: Moving the Economy Forward* (Lahore: Lahore School of Economics, May 2013).
15. *Pakistan Fiscal Policy Statement*, Ministry of Finance, Government of Pakistan (Islamabad: Ministry of Finance, Govt. of Pakistan, 2010–11).
16. Mustafa, Usman, *Fiscal Federalism in Pakistan: The 7th National Finance Commission Award*, PIDE Working Paper No. 73 (Islamabad: PIDE, 2011).
17. Pasha, Aisha Ghous, Pasha, Hafiz A. and Zubair Asma *Horizontal Equalization among the Provinces in the NFC Awards (Lahore:* Institute of Public Policy, Beaconhouse National University, 2010).
18. Ibid.
19. Hafiz Pasha, in correspondence with the author.
20. The view is of Dr M. Govinda Rao, Director, National Institute for Public Finance and Policy, New Delhi and Member, Fourteenth Finance Commission of India, expressed in correspondence with the author.

Part 5

Monetary Policy and Financial and Capital Markets

The two chapters in Part 5 of the book deal with the financial sector—banks and the equity market—and with monetary policy, savings, and inflation. These chapters on money and monetary policy examine the changing nature of the financial sector over the last few decades and we see to what extent monetary policy has become market-oriented following the financial sector reforms. The causes of persistent inflation and low savings are also analysed. We show that the cause of inflation in Pakistan is not excessive money creation, as is commonly believed, and that the reasons for low savings can be found in arguments which suggest financial repression, insufficient financial structures, cultural factors, and the presence of a huge illicit or black economy.

14 Financial and Capital Markets

Financial and capital markets in Pakistan have evolved from a state of near nothingness in 1947 to a situation today where Pakistan's banking and financial sector plays a formidable role in economic development and is integrated with the rest of the world. From a handful of bank branches at the time of Partition, the financial sector has expanded exponentially, now having branches in every nook and corner of the country. Along with banks, development finance institutions and other non-bank financial institutions played a leading role in providing credit to industry, agriculture, housing, and other sectors (see Figure 14.1). A securities market has also emerged as a conduit for investment funds. Syed Liaquat Ali summarizes the main components of Pakistan's financial sector:

> The financial sector in Pakistan comprises commercial banks, development finance institutions (DFIs), microfinance banks (MFBs), non-banking finance companies (NBFCs) (leasing companies, investment banks, discount houses, housing finance companies, venture capital companies, mutual funds), modarabas, stock exchange, and insurance companies. Under the prevalent legislative structure the supervisory responsibilities in case of banks, development finance institutions (DFIs), and microfinance banks (MFBs) fall within legal ambit of [the] State Bank of Pakistan while the rest of the financial institutions are monitored by other authorities such as Securities and Exchange Commission and Controller of Insurance. Under the Banking Companies Ordinance, 1962, the State Bank of Pakistan is fully authorised to regulate and supervise banks and development finance institutions. During the year 1997 some major amendments were made in the banking laws, which gave autonomy to the State Bank in the area of banking supervision. Under Section 40(A) of the said Ordinance it is the responsibility of the State Bank to systematically monitor the performance of every banking company to ensure its compliance with the statutory criteria, and banking rules & regulations. In every case in which the management of a bank is failing to discharge its responsibility in accordance with the applicable statutory criteria or banking rules and regulations or is failing to protect the interests of the depositors or for advancing loans and finance without due regard for the best interests of the bank or for reasons other than merit, the State Bank is empowered to take necessary remedial steps.[1]

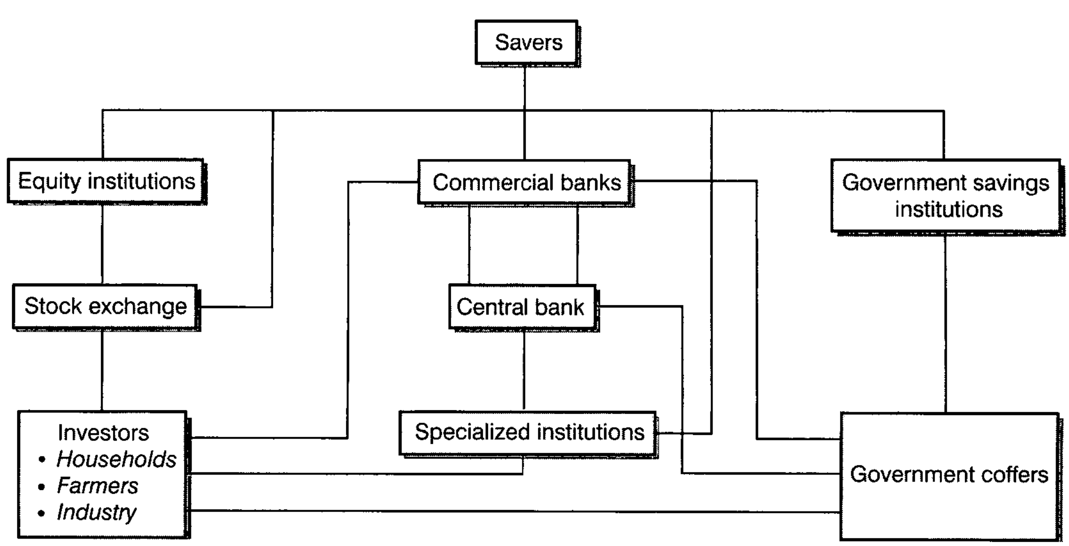


Figure 14.1
The System of Financial Intermediation in Pakistan

A modern and growing developing country is said to require a modern and advanced financial sector. Similarly, a modern and advanced financial sector supposedly works best in an economy that is money and market oriented. Moreover, conventional wisdom holds that 'the development of a vigorous domestic financial sector to channel domestic savings into high-return investment has been recognized as an important element of economic policy that seeks to generate economic growth. . . . In the development literature, considerable emphasis has been placed on the development of a sound commercial banking system based on a system of market-determined credit allocation'[2] (see Appendix 14.1 on the importance of the capital markets and the financial sector in Pakistan). The liberalization and deregulation that has taken place in the economy since November 1990 had particular significance for the financial sector. These reforms had been aimed at removing the constraints within the financial sectors in order to make financial capital more easily accessible. This chapter gives an account of the evolution of the financial and capital markets in Pakistan and then examines some key issues that affect the financial sector and, hence, the economy (see also Chapter 15 on the money market).

However, despite these generalizations and the arguments that Pakistan's financial sector supposedly plays a dynamic role in economic development, some surprising truths discussed below must make us think about the over-emphasis given to formal financial institutions, particularly the banking sector which this chapter deals with. We examine the nature of banking and credit in an economy which is very underdeveloped actually, despite all the claims made by economists and bankers about the importance of the formal financial sector. In a country where only 14 per cent of Pakistanis are using a financial product or service of a formal financial institution, such as savings, credit, insurance payments, and so on, and where 'the average Pakistani household remains outside the formal financial system, saving at home and borrowing from family or friends in cases of dire need',[3] clearly, our analysis of Pakistan's banking sector and of the formal financial institutions must be tempered with a great deal of caution about what the formal financial sector can actually do. Moreover, as we have discussed in earlier chapters, the absence of funds available to the dynamic informal and small-scale sectors, must mean that credit is not being made available to those who need it urgently.

14.1 The Development of the Banking Sector[4]

14.1.1 The First Phase: 1947–74

Although Pakistan gained political independence in August 1947, it would be fair to say that the country's economic and financial independence took many more years to acquire (even today there is some debate over whether Pakistan's economic and financial sectors are at all independent—see Chapter 17). The nature of industrial development outlined in earlier chapters shows how little developed industry was at the time of Partition. The banking and financial sector suffered a similar fate due to Partition, and the areas which became Pakistan were severely under-represented in terms of banking and financial services.

At Partition, Pakistan had no central bank or banking system. The Reserve Bank of India, which was legally common property for both India and Pakistan, continued to operate as a currency and banking authority for Pakistan, and had its operations directed and controlled from New Delhi until June 1948.[5]

Prior to Partition, of the 99 scheduled banks listed on the Second Schedule of the Reserve Bank of India, only one had its office in Pakistan.[6] United India had 3,496 branches of scheduled banks, but only 631 were located in the areas that were to become East and West Pakistan. The paid-up capital and reserves of these banks amounted to no more than 10 per cent of the total paid-up capital and revenues of undivided India. These banks were small compared to their counterparts in India, and their share of deposits, advances, and bills discounted was just one-tenth of the total. The areas that were to become Pakistan had very few branches, and once Pakistan came into being, the number of branches decreased further. Of the 631 branches before Partition, only 213 were functioning when Pakistan came into being. The paid-up capital and reserves decreased from 10 per cent of undivided India to a mere 1.5 per cent after Partition.[7] A year later, when the State Bank of Pakistan was established, the number of branches of scheduled banks had dwindled to only 195, of which only 65 existed in Pakistan.[8]

The communal violence and subsequent migration that followed Partition had major repercussions for the financial sector. In the financial sector as well as in trade and commerce, it was the Hindus who controlled a large part of the industry in the areas that became Pakistan, especially in the more developed region of the Punjab. The Hindus migrated to India *en masse* with all economic activity coming to a standstill. With a large number of commercial banks ceasing to function, sources of all types of credit for trade, commerce, and agriculture dried up. While informal moneylenders began to migrate to India, the closure of branches in the formal sector also implied the exodus of managerial and administrative staff, who were mainly Hindu. Most banks were controlled and owned by Hindus, and the services they rendered were no longer available after their head offices were transferred to India. The only scheduled bank that remained in Pakistan was the Muslim-owned Australasia Bank, which was just too small and ill-equipped to handle the business that was transacted by the migrating Indian bankers. The acute shortage of skilled staff was another key factor in inhibiting the evolution of even a basic system of banking.[9]

The State Bank of Pakistan began operations on 1 July 1948 and became the sole note-issuing authority, but the government of Pakistan at that time had no note printing press to print them on. The State Bank of Pakistan was faced with the gigantic task of establishing a banking system after the collapse at its time of Partition.

Despite the exodus of banks and the closure of Indian banks at the time of Partition, the number of Indian bank branches functioning after Partition was greater than

the number of non-Indian branches. The non-Indian (i.e. foreign) banks were mainly confined to financing import and export trade. These banks were subject to control and guidance from their head offices in almost all matters related to financing. However, their impact can be seen from the fact that on 1 July 1948, of the total bank deposits of Rs. 1.1081 billion held in Pakistan, as much as 73 per cent was held by foreign banks whose activities were largely confined to foreign trade.[10]

In the first eighteen months of the operation of the State Bank of Pakistan, 51 new branches were opened in both East and West Pakistan, of which 28 were Pakistani banks, 12 were Indian, 4 were exchange (i.e. foreign) banks, and 7 were opened by the newly formed National Bank of Pakistan, of which 6 were in East Pakistan. By December 1949, there were 35 scheduled banks in Pakistan, of which 4 were Pakistani, 23 Indian, and 8 exchange banks. These banks had 109 branches in West Pakistan and 83 in East Pakistan. Interestingly, though, of the 59 branches of Pakistani banks, only 7 were in East Pakistan. Exchange banks were confined to the port towns of Chittagong and Karachi, while some were granted permission to open branches at provincial headquarters if there were European or other foreign firms that required banking services, or had trade with foreign countries. The role of the National Bank of Pakistan until June 1950 was restricted to financing jute operations.[11]

As the number of branches of the commercial banks expanded in the 1950s, these banks continued to mobilize increasing domestic savings, which were then channelled into the demand for credit in the economy. While most credit was used to finance foreign trade and commerce in the late 1950s, commercial banks started playing an important role in supplying credit to domestic industries as well. Moreover, as time went on, Pakistani banks began to play an increasing role in financing economic development. In 1952, of the total advances made to different sectors, 38 per cent were by Pakistani banks, 22 per cent by Indian banks, and 40 per cent by foreign banks. In 1955, Pakistani banks supplied 59 per cent of credit advanced,[12] and by 1970 this had risen to as much as 89 per cent.[13]

Over the years, as the number of branches of banks began to grow, the State Bank of Pakistan decided to set up a system of new branches under which a certain quota had to be opened in regions designated by the State Bank. Commercial banks were asked to extend their areas of operation to regions that were not particularly economically viable. As most industry and commerce, as well as agriculture production, was taking place in West Pakistan, it is not surprising that most of the new branches were opened in the western province. In 1963 there were 957 branches in both wings, with the more populous eastern wing having less than 35 per cent of bank branches.[14] The State Bank of Pakistan ordered commercial banks to open one branch in East Pakistan for each branch they had in West Pakistan. The fears that the State Bank's policy of opening new branches in places where there were no banks proved to be quite unsound and misplaced. However, within a year of their establishment, most of the branches had become viable. According to the State Bank of Pakistan,

> the branches licensing policy was not meant to obstruct the growth of the banking system but to foster it in the best national interest. In 1966 the State Bank of Pakistan fixed quotas for new branches for each bank every year, and prescribing the ratios for city and urban and rural branches. The quota of each bank was determined on the basis of its financial position, availability of trained personnel, soundness of its management, and its capacity to open and operate the new branches without an adverse effect on its financiers.[15]

In the early 1960s, licences were given to known business magnates and parties which were deemed to be financially sound. This posed an interesting dilemma. Known business magnates and sound parties were, by definition, those who already had wealth and were able to invest it. There was a risk, then, that a further concentration of economic power would take place and a close nexus between industry and banking would emerge. The official history of the State Bank of Pakistan examines this issue as follows:

> The distribution of bank credit was a function of various government policies including those covering the grant of permission for setting up industry and import licensing. There was no denying the fact that though emphasis seemed to be gradually shifting in favour of the smaller parties, the bigger parties still enjoyed, by far, a predominant position. Bank credit had necessarily to follow the overall pattern of public policy which had permitted the establishment of such undertakings. . . . It was also agreed that big business was already placed in favourable positions in the matter of credit availability. Since banking business had become a highly lucrative enterprise, big businesses were naturally motivated to exploit this opening. They also evinced interest in this activity as a great deal of influence went with the control of banking institutions.[16]

14.1.2 The Relationship between Economic Growth and the Development of Banking

There is a very close relationship between the nature and extent of economic growth and the growth of the banking sector. The pattern and sizes of deposits, the types of credit available, the locations of bank branches, etc. all influence the pattern of economic development in a country. This is more marked when a country is underdeveloped and in the earlier stages of development. Some observations regarding Pakistan's banking sector until the 1960s allow ample reflection on the nature of Pakistan's economy and society in the earlier years.

Not surprisingly, the demand for industrial credit in the early years was quite low. There was very little industry to begin with, and hence little demand for credit. 'The demand for credit in the early years was not very large. . . . The

affluent class during this period was more interested in commerce than in industry, as it could quickly multiply its riches in trade rather than in any other branch of economic activity.'[17] These facts have been confirmed by our analysis in Part II of this book, particularly in Chapters 6 and 9.

In the period 1948–54, bank deposits grew by 61 per cent, a very high rate by any standard. It is interesting to observe that this growth was very closely linked with that of the overall economy. Five broad reasons are given by the State Bank of Pakistan for this growth:

1. The revival of economic activity across the country, which had come to a sudden halt immediately following Partition
2. The rehabilitation and consolidation of the banking sector
3. The inflow of Muslim capital from other countries following the birth of Muslim Pakistan
4. The increase in development activity, especially in the industrial sector, which resulted in the growth of money incomes—especially in urban areas where banking facilities were better developed
5. A generally favourable balance of payments on the private account.[18]

Within this six-year period, bank deposits showed a trend that was closely in line with economic activity. For example, bank deposits increased in 1951 due to enhanced export earnings following the Korean War boom and the favourable balance of payments position on the foreign account. The next year, 1952, deposits fell, as there was a reversal in the terms of trade, a fall in export incomes, and an increasing amount spent on imports. Between 1952 and 1954, deposits increased again, mainly due to the reduced scale of commercial activity and the beginning of the flotation of share capital of a number of companies.[19]

In 1953, the financing of economic activity by banks was highly focused on commercial activity, which received 48 per cent of all advances made by banks in that year. This shows that commerce must have been quite profitable to consume such a large share of funds. The bulk of loans for commerce were utilized in financing the wholesale and retail trade of the country. The dearth of industrial activity is reflected in Table 14.1 and Figure 14.2, which shows that in 1953 manufacturing received only 16 per cent of advances made; of this, one-third went for metal products and one-fifth for textiles. Not surprisingly, a greater share of credit was extended to West Pakistan than to East Pakistan (see also Chapters 6 and 9).

In the 1960s and 1970s, much of the pattern of credit disbursement changed, following the changes in the economy. As manufacturing progressed from the 1950s, through the boom of the 1960s, so did the credit available to the sector. In 1963, manufacturing received 37 per cent

Table 14.1
Scheduled Banks' Advances by Economic Group: 1953, 1963, 1972, 1977, 2000, and 2010 (Rs. m), percentages in parenthesis)

Economic Groups	Unit	June 1953	June 1963	June 1972	June 1977	June 2000	June 2010
Agriculture, forestry, fishing, and hunting	Rs. m	94.8	232.7	1,156.8	4,632.5	97,444.6	165,974.2
	%	(18.4)	(7.0)	(9.3)	(15.8)	(18.7)	(8.1)
Mining and quarrying	Rs. m	0.3	11.6	62.5	381.9	9,694.3	14,979.1
	%	(0.1)	(0.4)	(0.5)	(1.3)	(1.9)	(0.7)
Manufacturing	Rs. m	82.4	1,236.5	6,124.3	12,576.9	304,721.8	1,228,536.4
	%	(16.0)	(37.4)	(49.3)	(42.9)	(58.3)	(60.2)
Construction	Rs. m	7.9	90.5	149.9	698.7	5,934.3	65,825.6
	%	(1.5)	(2.7)	(1.2)	(2.4)	(1.1)	(3.2)
Electricity, gas, water, and sanitary services	Rs. m	1.1	7.3	68.8	101.3	3,749.2	209,776.8
	%	(0.2)	(0.2)	(0.6)	(0.3)	(0.7)	(10.3)
Commerce	Rs. m	217.0	1,315.7	3,182.8	6,146.1	78,169.5	220,443.9
	%	(42.2)	39.8	(25.6)	(21.0)	(15.0)	(10.8)
Wholesale and retail trade	Rs. m	-	1,228.6	2,981.0	5,723.4	31,380.4	120,150.7
	%	-	(37.1)	(24.0)	(19.5)	(6.0)	(5.9)
Transport, storage, and communication	Rs. m	12.3	76.3	305.5	391.4	11,614.6	102,505.1
	%	(2.4)	(2.3)	(2.5)	(1.3)	(2.2)	(5.0)
Services	Rs. m	67.5	257.6	924.8	2,633.6	6,645.0	21,519.3
	%	(13.1)	(7.8)	(7.4)	(9.0)	(1.3)	(1.1)
Employees and activities not adequately described	Rs. m	31.3	79.9	457.6	1,720.3	4,352.4	11,084.7
	%	(6.1)	(2.4)	(3.7)	(5.9)	(0.8)	(0.5)
Total	Rs. m	514.6	3,308.1	12,433.0	29,282.7	522,325.7	2,040,645.1

Source: State Bank of Pakistan, *Banking Statistics of Pakistan* (Karachi: various issues).

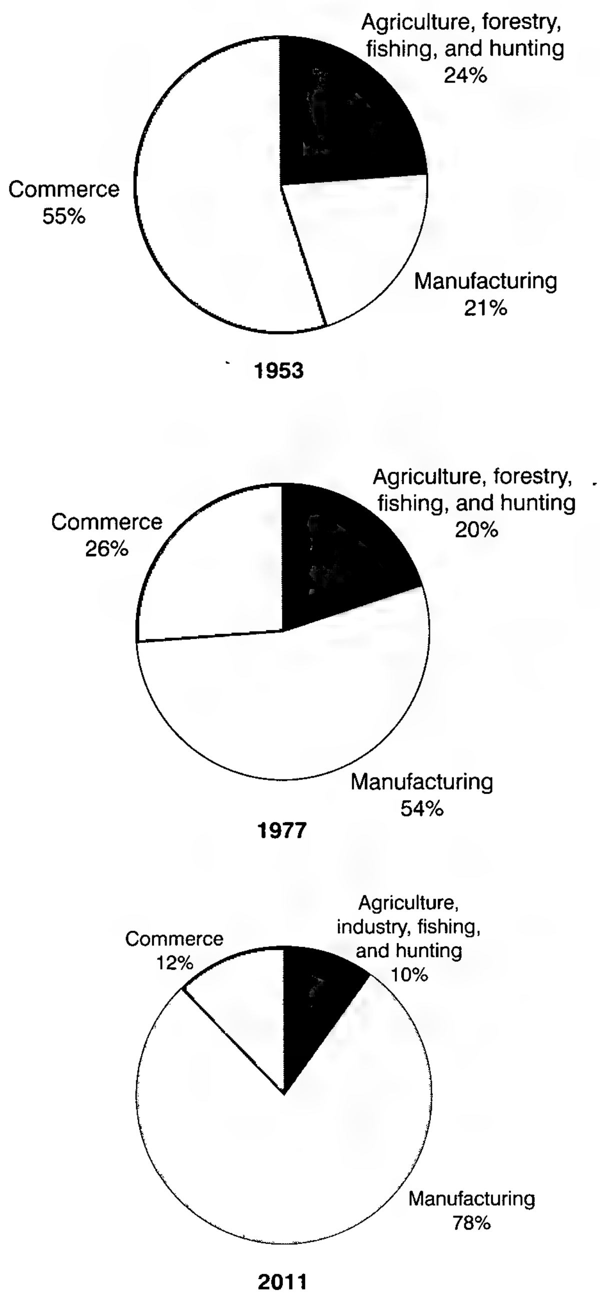


Figure 14.2
Scheduled Banks' Advances by Economic Group (% share)

of credit, while in 1972 it received almost half, with textiles gaining the largest single share. Advances for commerce, in relative terms, declined from 42 per cent of the total in 1953 to 26 per cent in 1972. Essentially, as the economy grew throughout the 1960s, so did banks. Moreover, the pattern of economic concentration that had emerged in industry was soon reflected in the ownership of banks and in the distribution of bank credit. For example, on 31 March 1959, 63 per cent of the total bank credit was tied up in only 222 bank accounts of Rs. 1 million and above.[20] On the other hand, advances under Rs. 25,000 accounted for only 6 per cent of the total credit. On the face of it, this pattern would seem inequitable to most. However, given the distribution of wealth in industry and the type of industry being implanted in the 1950s and 1960s—essentially large scale—the pattern of the disbursement of credit should not come as a surprise. It is unlikely that economic growth of the level prevalent in the 1960s could have taken place without the active role and participation of the banking sector. This relationship was, moreover, mutually beneficial.

14.1.3 Nationalization in the 1970s

On the first day of 1974, the Bank Nationalization Ordinance was promulgated, according to which the federal government had exclusive rights of ownership, management, and control of all banks in Pakistan. The shareholders of banks were compensated for their holdings in the form of Federal Bonds repayable on par at any time within a period of fifteen years. Although the banks were nationalized by the Bhutto government in accord with the People's Party's manifesto when the party had been in office for more than two years, the roots of nationalization actually rest in the developments in the economy and the banking sector in the 1960s, a fact not very well known to most people.

A number of malpractices in the banking sector had begun to be identified, despite the success of the sector, as early as 1962. The State Bank was concerned that there was a maldistribution of credit amongst the different segments of the economy. The concentration of credit in a small class of big borrowers was observed and given the role of the private sector in industry and banking, the State Bank was not legally empowered to bring about any change in the ownership structure of commercial banks. Furthermore, there was no legal obligation to earmark a percentage of bank advances for the development of businesses other than big businesses. The private sector, particularly those with greater wealth and capital, flourished in the 1950s and 1960s, and given the nature of developments, the close connection between industry and banking was an inevitable outcome.

In July 1969, fourteen major banks in India were taken into state ownership. This influenced the thinking amongst planners in Pakistan. Leading Pakistani economists in the Planning Commission were impressed by the performance of the Indian banks, and so favoured the nationalization of banks in Pakistan as well. They argued that a reform of the banking system was needed to carry out any meaningful improvement in the structure of industry and the distribution of income to achieve some measure of social justice. Even foreign experts had begun to argue that the economy was in bad shape and identified the banking system as being responsible for many ills.[21]

Of the four largest banks in Pakistan, only one was state controlled, while the other three were owned by industrialist families, viz. the Habibs, the Saigols, and the Adamjees. These four banks monopolized 75 per cent of total deposits and two-thirds of earning assets. The three private sector banks between them had half of the total deposits and earning

assets. Apart from the top three private banks, there were four others owned by the Dawoods, Fancys, Sheikhs, and Haji Habib. These seven private banks were owned by business houses and accounted for as much as 92 per cent of deposits held by all local banks.[22] It is not at all surprising, then, that these family-owned banks promoted and patronized companies owned by them in the provision of credit. This sort of collusion gave rise to a further concentration of wealth.

However, the State Bank of Pakistan was quite realistic about these developments, stating quite rightly:

> If import licences and industrial sanctions were mainly restricted to a few big parties, banks could not possibly refuse accommodation to them. In fact, under the circumstances, banks' failure to provide necessary credit to them would have been detrimental to investment and economic growth. Similarly, concentration of credit in a few industries and commercial cities was a corollary of the location of trade and industry that developed within the broad policy framework of the government. Given this background, credit disbursement would have followed the same pattern irrespective of the type of ownership of banks.[23]

The discussions at that time concerned remedial measures to deal with the issues related to the banking system and were, incidentally, quite independent of whether banks remained in private hands or were nationalized. The State Bank of Pakistan position towards nationalization was completely neutral.

In September 1970, a State Bank report revealed that only eighty-eight accounts in Pakistani banks had access to as much as 25 per cent of total bank credit. Most of these account holders were directors of the banks themselves.[24] Nevertheless the State Bank was unambiguously clear about such issues and argued that it was 'not correct to assume that the nationalization of banks per se could ensure a more equitable distribution of banks' resources between people and regions. Some people held the view that bank credit was not the cause of concentration of economic power but the result.'[25] In light of this background, banking reforms were undertaken in 1972 and were so wide-ranging in their scope that people began to believe that the nationalization of banks in the country, which had appeared imminent, had been pushed into the background. However, this was not the case.

Fourteen banks were nationalized, of which thirteen were merged into five banks. The State Bank of Pakistan was also nationalized; the official history of the State Bank of Pakistan writes that 'this was perhaps the unique case in the banking world where the central bank of the country was simultaneously nationalized along with the commercial banks'.[26] Thirty-nine years after the event, of the five banks, four had been privatized. Although some of the more salient traits and consequences of nationalization are presented in more detail in other sections, some early developments provide an insight into the concerns that were emerging very soon after nationalization.

There was concern that now that the powerful and lucrative banking sector was in government hands it was open to political pressure and to misuse. In a number of cases in the early years following nationalization, loans and advances were made on considerations not conforming to professional standards. The high-risk (classified) advances of the banks grew disproportionately in the total loans portfolio. The performance of banks came under severe criticism for growing inefficiency and deteriorating service standards, and for holding monopoly power which permitted them to charge very high interest rates. Some socioeconomic objectives were met when nationalized banks were ordered to open branches all across the country in every township that had a population of over 2,000 inhabitants. While this played a key role in bringing the extensive non-monetized economy into the more formal sector and may possibly have encouraged savings, there were some drawbacks too. Banks became overcrowded and overstaffed for political reasons. They now had their branches in streets and *mohallas* of residential areas regardless of their deposit potential, and there were cases where branches of nationalized banks were located next to each other. (Some more issues regarding the role and performance of nationalized banks are discussed in subsequent sections of this chapter.)

14.1.4 Islamic Banking

In 1979, Pakistan embarked on an extensive process of Islamization, with the financial sector undergoing substantial changes in the process. Two months after coming to power, in September 1977, General Zia ul-Haq had asked the Council of Islamic Ideology (CII) to prepare the blueprint for an interest-free economic system in the light of Islamic teachings. In its two main reports, the CII recommended the immediate removal of interest from some financial institutions, with the intention of doing away with interest from all domestic financial transactions.

In February 1979, the government announced that it intended to remove interest from the economy in three years, and it began with the elimination of interest from the House Building Finance Corporation, the National Investment Trust, and the mutual funds of the Investment Corporation of Pakistan. From July that year, the government ordered the nationalized commercial banks to provide interest-free loans to small farmers for meeting their seasonal agricultural financial requirements. This scheme was expanded to fishermen and co-operative societies in 1980.

In January 1981 all five nationalized commercial banks set up separate counters to accept non-interest-bearing profit and loss sharing deposits. From 1985 onwards, no bank was allowed to accept any interest-bearing deposits, except foreign currency deposits, which continued to earn fixed interest rates, while all other accounts shared in the profit or loss earned by that bank.

In addition to these steps, three Islamic modes of financing were launched: *musharakah*, *murabaha*, and *mudarabah*. *Musharakah* means decreasing participation: a bank participates as a financial partner in a profitable project, on the basis of an agreement by the other partner that the bank will receive a certain part of the net profit actually realized, and is entitled to retain the remaining part as may be agreed

Table 14.2
Branches and Deposits in Banks in Pakistan (including foreign banks): 1964–2010
(All figures are as of June of the relevant year)

Year	No. of branches	% change	Total no. of accounts	% change	Nominal deposits (Rs. m)	% change	Real deposits[a] (Rs. m)	% change	Savings accounts as % of total accounts	Savings deposits as % of nominal deposits
1964	1,298	–	01,907,011	–	06,501.9	–	6,052.0	–	–	–
1971	3,418	7.82	07,275,719	140.20	15,593.2	10.35	11,120.0	5.35	78.06	35.32
1977	6,737	17.66	11,970,966	11.79	42,494.5	14.16	13,116.8	3.16	80.46	40.39
1985	7,120	–0.96	21,215,465	3.55	151,194.5	16.61	25,112.5	11.55	79.25	42.46
1990	7,404	2.07	24,323,793	–3.25	279,254.3	13.65	34,527.0	8.70	89.72	44.75
2003	7,194	–2.84	28,828,888	18.5	1,681,528	500	–	–	75.0	56.97
2005	7,105	–1.24	26,984,619	–6.40	2,428,294.0	44.41	–	–	71.45	52.06
2010	9,096	28.02	26,575,854	–1.51	4,693,117.1	93.27	–	–	55.15	39.29

Source: State Bank of Pakistan, *Banking Statistics of Pakistan* (Karachi: SBP, various years).

were implemented, the private sector began to play a bigger role in development. A major shift in emphasis in favour of the private sector is also reflected in the allocation of bank advances to the private sector. Not surprisingly, textiles claimed about one-eighth of all advances in 1991 which grew to one-fifth by 2001 but fell again as the economy slowed after 2008. See Box 14.2 on non-performing loans.

During the 1991–2010 period, there was a small rise in government borrowing as shown in Chapters 10 and 11, and a large contraction in advances to the private sector. We have shown in earlier chapters and as we do in Part VI of this book, that in the 1990s, especially after 1996, the private sector investment has not been very forthcoming, and perhaps that is reflected in the credit advanced to the private sector. It is also important to point out that while credit may be advanced for investment purposes, it may actually not be used for productive purposes, and may be used for speculative (on the foreign exchange market) purposes or become part of capital flight. Throughout the 1990s, the case of bad loans, or loans given not for the purposes for which they were meant, caused a great deal of pressure on the banking sector, with many borrowers defaulting on their loans. As the State Bank of Pakistan: *Financial Sector Assessment 1990–2000* stated, 'the government ownership of commercial banks resulted in political intervention into credit allocation and credit recovery decisions besides other institutional inefficiencies. As a result, inflated loans increased sharply, financial institutions suffered loses, and quality of service plummeted.'[28]

Box 14.2

The Burden of Non-Performing Loans

In 1997 non-performing loans are estimated to be worth Rs. 140 billion, raising significant problems for the portfolio of banks.

Over the years the capital base of NCBs has been severely affected by the poor quality of bank loans made primarily on political and uneconomic grounds. As a result the single most formidable problem facing the banks is the heavy burden of non-performing loans. Although rescheduling of loans is common, the total advances of NCBs categorized as bad and doubtful debts are Rs. 56 billion; Rs. 45.9 billion of these classified advances relate to the private sector. Just under 23 per cent of the private sector's classified debt pertain to advances under mandatory targets and concessional credit schemes. In 1989 SBP estimated that around 14.2 per cent of the lending portfolio of NCBs needed to be provided against.

The position of DFIs is even more delicate than that of commercial banks. Provisions against bad loans have increased from 0.1 per cent of assets in 1980 to 0.9 per cent in 1991. It is estimated that about Rs. 13 billion was stuck up in non-performing loans, representing 30 per cent of the portfolio, Rs. 6 billion of which was in respect of cases that had been in litigation for more than one year.

The problem of debt recovery is not simply a technical issue. Not only have political pressures affected the quality of the loan portfolio of banks, they have also been instrumental in preventing banks to proceed against persistent defaulters and have resisted attempts to improve the enforcement mechanisms.

Source: Haque, Nadeemul and Shahid Kardar, 'The Development of Financial Markets in Pakistan', unpublished mimeo, 1993, 14–15.

Table 14.3
Scheduled Banks' Advances: June 1985, 1991, 2001, and 2010

	Million rupees				% share			
	June 1985	June 1991	June 2001	June 2010	June 1985	June 1991	June 2001	June 2010
Government	14,050.8	18,674.3	75,849	423,866.80	12.5	7.9	8.7	13.4
Public sector enterprises	18,058.8	16,434.9	88,089	210,440.40	16.1	7.0	10.2	6.6
Private sector	69,637.3	178,899.5	611,508	2,193,624.00	62.4	76.1	70.8	69.1
Agriculture, forestry, hunting, and fishing	14,029.1	51,301.8	96,497	165,974.2				
Mining and quarrying	464.9	942.7	8,104	14,979.10				
Manufacturing	33,765.2	72,769.	354,847	1,233,442.70	30.2	30.9	41.0	38.9
Textiles	13,266.6	30,195.5	169,496	456,139.90	11.9	12.8	19.6	14.4
Construction	2,155.1	3,896.6	6,399	65,825.60				
Electricity, gas, water, and sanitary services	115.5	963.3	4,430	209,776.80				
Commerce	14,896.6	33,710.0	76,831	220,443.90	13.3	14.3	8.9	6.9
Wholesale and retail trade	5,269.7	13,251.3	31,718	120,150.70				
Transport, storage, and communication	648.3	1,239.5	10,653	102,505.10				
Services	709.9	2,144.1	6,869	153,284.7				
Other private business	2,852.6	11,932.6	46,875	27,391.80				
Trust funds and non-profit organizations	100.4	336.6	8,249	13,309.60				
Personal	8,806.2	20,473.0	73,752	322,138.00			8.5	10.1
Other activities not adequately described	1,001.8	156.4	6,812	11,084.70				
Total	**111,655.3**	**235,074.9**	**864,261**	**3,174,463.50**				

Source: State Bank of Pakistan, *Banking Statistics of Pakistan* (Karachi: various issues).

14.1.7 Development Finance Institutions (DFIs) and Non-Bank Financial Institutions (NBFIs)

Development Finance Institutions (DFIs) have, historically, played an important part in financing development projects in many developing countries, including Pakistan. However, over the years, as the role of the state has receded from development, many of the state-owned DFIs have been privatized or merged into other, more conventional commercial banks. DFIs used to provide long-term debt, and in 1993/4 sanctioned loans worth Rs. 26 billion. The practice until some years ago was that DFIs acted as conduits for government funding, which was then made available to users. In addition, credit from multilateral agencies, guaranteed by the government, was utilized by DFIs. DFIs, which had some autonomy previously, were eventually brought under the regulatory control of the State Bank. Since DFIs were also highly controlled by the government, like nationalized banks, DFIs were been able to maintain institutional autonomy. Political pressures, rather than economic and financial expediency, had been responsible for advancing loans, which resulted in a significant loan arrears problem. Furthermore, given the nature of the changes in Pakistan's economy, with deregulation and liberalization on the one hand, and with changes in the financial structure on the other, it is not surprising that DFIs became more like banks, and banks had to make long-term loans, thus eroding the previously protected position of DFIs. Many of the DFIs have now been incorporated into banks.

The main constituents of the non-bank financial sector are leasing companies, *mudarabahs*, investment banks, and housing finance companies. Leasing companies are a relatively new phenomenon in Pakistan. However, leasing grew at a rate of about 70 per cent during the 2000s. In 1990, the DFIs, had a share of 78.6 per cent of the assets of all non-bank financial institutions (NBFIs); by 2000, this had fallen to 57 per cent. Investment banks had increased their share in the same period from 1.8 per cent of total assets to 12 per cent, and leasing companies assets increased from 4.7 per cent to 11 per cent. These three constituted 80 per cent of total assets in the NBFI sector. DFIs dominated considerably in terms of deposits (62 per cent of deposits of NBFIs), and in term of loans as well (72 per cent). Investment banks and leasing companies were the next biggest players. The State Bank's Financial Sector Assessment report reveals that the annual growth rate in assets, deposits and loans for the NBFIs sector as a whole was substantial and positive—in fact in double digits usually—for the period 1990–97; from 1997/8, there was a sharp negative fall until data is available 1999/2000.[29] The double-digit compound annual growth rate for all three categories—assets, loans, and deposits—fell after the May 1998 nuclear tests, when deposits were withdrawn (or were not

forthcoming any longer), and capital flight took place and there were few borrowers at a time of numerous political and economic crises. Just as the overall economy shrank and was squeezed, so was the NBFIs sector. See Box 14.3.

14.1.8 Some Salient Issues in the Banking Sector

Although most commercial banks have large asset bases, and for this reason there is great potential for them to explore further possibilities to develop medium- and long-term lending facilities, constraints in the present structure impede this potential. While the asset base may be large, the large holdings by banks of government securities cannot be lent or borrowed against. Thus, banks could provide capital by subscribing to corporate convertible commercial bonds/papers, and be more involved with DFIs in consortium financing for projects, only if they had a freer hand in determining their own portfolios unhindered by government directives.

However, the constraints that banks face in term lending include their ability to mobilize medium- and long-term resources. At the moment, given the structure of the banking system, banks do not have large long-term resources. It is also believed, often incorrectly, that many commercial banks, unlike DFIs, do not have the expertise for making medium- and long-term loans on the basis of economic viability, technical feasibility, and financial profitability. The nationalized commercial banks (NCBs), which used to constitute about 85 per cent of the banking system in Pakistan, were constrained by a management regime that was very bureaucratic, and like all government departments, the banks were highly centralized, and initiative by middle and lower-level executives was not particularly encouraged or appreciated.

Pakistani banks, since they formed a major part of the public sector, were not immune from political pressures to make loans for projects that did not satisfy the basic criteria of financial soundness or viability. Local banks and DFIs were very often used to provide financial favours to politically well connected individuals, thus often undermining all basic banking principles (see Box 14.2). It is estimated that in 1997 'non-performing' loans made by the banking sector accounted for around Rs. 140 billion, or almost 6 per cent of GDP. This problem, which has its roots in political patronage and corruption, was one of the main impediments to the further privatization of banks. The State Bank of Pakistan injected a large amount of capital into these NCBs to make them look more viable for privatization. Moreover, large scale management change in all NCBs also helped turn around the performances of those banks which were eventually privatized.

Box 14.3

Development Finance Institutions in Pakistan

Syed Liaquat Ali gives a brief history of DFIs in Pakistan.

Historically DFIs in Pakistan have common features; most of them were started with seed money from the Government of Pakistan and support from the International Financial institutions. State Bank of Pakistan has also played a pioneering role to structure these financial institutions and was in the past responsible for providing rupee lines of credit. . . .

. . . DFIs were major channels for routing development funds to the private manufacturing sector and achieving the desired socio-economic objectives, such as encouraging new entrepreneurs, promoting industries in less developed areas, and wider diffusion of industrial ownership.

The DFIs were also assisting the Government in screening new development projects, framing economic development plans or policies, rehabilitating sick or problem projects, administering or supervising special loans provided by the government or foreign institutions, and participating in the promotion of other DFIs for achieving related socioeconomic objectives.

Besides promoting establishment of import-substitution industries, the DFIs encouraged capital formation by directly investing or underwriting shares and debentures issued by the local companies. They also assisted Pakistani entrepreneurs in obtaining suitable foreign investment, attracting foreign investors in formation of joint ventures with local partners and assisting in obtaining technical/managerial advice for businesses and industries.

Many industries were made operational, enormous jobs were created both in the operational and service sectors and the country was on the road to economic and social progress. However many DFIs ran into problems stemming basically from poor management and excessive loans without proper due diligence. Unlike the cases of certain commercial banks, neither there were efforts to inject fresh equity or soft loans into problem DFIs, nor there was a serious attempt to restructure them. The problem DFIs, were merged into other DFIs/ commercial banks or were liquidated.

Pakistan, still a low income, developing country, badly needs the services and facilities offered by the DFIs for achieving socio-economic objectives and well-being of the people, particularly in the underdeveloped areas.

In India, IDBI and ICICI were two premier DFIs at a time when we in Pakistan had DFIs like PICIC and NDFC. Unlike Pakistan, the role of these two institutions has been substantially enlarged over the period. In order to further enforce their role, to supplement their low cost funding sources and enhance their profitability they were granted licenses for commercial banking business. Both the institutions were restructured to keep them in line with changing market conditions. IDBI Bank and ICICI Bank are profitably financing infrastructure and other development projects in India whereas we have allowed PICIC and NDFC to wither away.

Ali, Syed Liaquat, 'Development Financial Institutions', Supplement on DFIs, *Business Recorder*, Karachi, 11 October 2011

In a study conducted by the National Development Finance Corporation (NDFC) in May 1993, a comparison of foreign and private sector banks was made with NCBs. (In 2003 there were twenty-four Pakistani scheduled banks and sixteen foreign banks operating in Pakistan.) It was found that between 1986 and 1991 the proportion of commercial banking assets owned by foreign banks grew from 6 per cent to 14 per cent. In 1991, the three largest NCBs accounted for 72 per cent of loans, 73 per cent of deposits, and only 33 per cent of pre-tax profits. The three largest foreign banks used 5.4 per cent of the sector's assets, 4.6 per cent of loans, and 5.5 per cent of deposits to generate over 24 per cent of profits. Total pre-tax profits earned by NCBs amounted to Rs. 2.2 billion on a paid-up capital of Rs. 6.4 billion, while foreign banks earned higher profits of Rs. 3.5 billion on a lower paid-up capital of Rs. 3.3 billion.[30]

There was a noticeable difference in efficiency and performance between state-owned nationalized commercial banks and foreign banks. Foreign banks had shown the highest growth rate in terms of deposits in 1996–99, with an annual growth of 31.4 per cent, compared to 12.7 per cent for NCBs and 18.2 per cent for the privatized banks. Furthermore, in the same period, foreign banks had been able to control administrative costs, restricting their growth to 17.6 per cent, compared to 19.7 for nationalized and 18.3 per cent for privatized banks. The gross revenues of foreign banks had also grown at a much faster rate than the increase in costs. In the case of some domestic banks, the costs exceeded growth in revenue. Administrative costs for NCBs had been 2 per cent of total assets, compared with 0.85 per cent for foreign banks, while the rate of return on total assets for foreign banks ranged from 1 to 2.4 per cent, compared with only 0.1 to 0.3 per cent for local banks.[31]

Although the above comparisons clearly show that foreign banks outperformed the local banks, particularly nationalized banks, it is important to emphasize the difference in how they function. Foreign banks neither competed in the same markets nor were subjected to the same degree of political pressure to hire staff and advance/reschedule loans, as was the case for nationalized banks. Furthermore, NCBs were forced to make advances to the agricultural sector, which often results in an increase in the number of bad loans. Also, it is not surprising that foreign banks were more profitable in terms of shareholders' equity, assets, and net spread on funds. Efficiency ratios revealed that the NCBs were the least efficient. The maintenance of a large number of unprofitable branches in order to provide banking services to rural areas necessitated the incurring of fixed operating costs that were not particularly helpful in generating revenues for the NCBs. Furthermore, other than the numerous problems and hindrances highlighted above, which affected the emergence and functioning of an efficient banking system, the issue of direct credit has been of particular concern to nationalized banks. These banks were directed by the government of Pakistan to provide credit to specific sectors and at specific times, irrespective of economic and financial considerations. It is quite possible that the majority of these loans were bad loans with a low probability of being returned (see Chapters 16 and 17 on the Structural Adjustment Programme and its implications for the financial sector).

Since the late-1990s, there have been many changes in Pakistan's banking sector. Compared to the past when there were five large NCBs, there is only one, the National Bank of Pakistan, which is large and fully government owned. There are now three specialized banks in the public sector which make long-term investment loans; there are three provincial banks in the public sector; and there are 16 private banks. The number of foreign banks has fallen markedly, from 22 in 1996 to only 7 in 2012. Many of the foreign banks have left Pakistan because of terrorist/security concerns and fears and because Pakistan's economy has not done well; especially after the nuclear tests and the freeze on foreign currency accounts in 1998. Some of these foreign banks sold their local assets to Pakistani private banks. In the Musharraf-Shaukat Aziz false boom of high liquidity following 9/11, after 2002 and until 2007, when the government began to project Pakistan as one of the new rising economies, foreign banks bought in to this sham, and new banks opened branches in Pakistan. Once the shine had gone along with Musharraf and his prime minister, and the global economic crisis set in, with Pakistan's economy slowing appreciably, many of the same foreign banks had to pack up and leave.

As we show above, in the mid-1990s, the performance of foreign banks was far better than that of domestic, particularly nationalized, banks, but there are reasons why this was not a fair comparison. Now with greater competition, better administration and management, cleaner portfolios, less political interference, and a host of other factors, the performance of private Pakistani banks is said to have improved considerably. It is quite possible that some of the Pakistani banks will be able to emulate the standards set by some foreign banks. Moreover, with the market determining credit allocation—as opposed to directed credit—the nature and structure of banking in Pakistan is undergoing considerable change. Directed credit, to the right sectors at the right time, has been a key factor in promoting growth and development in many countries, including East Asian countries. Even in Pakistan, certain sectors have been given priority for credit at certain times. Now with the market determining credit allocation, there is always a fear that non-productive areas—like personal and consumer finance, leasing, etc.—may attract larger loans and create financial bubbles. In the liquidity boom of the Musharraf-Aziz years of 2002–07 (see also Chapter 18), banks in Pakistan made huge profits and new banks opened up and were lured to the financial sector. Some traders from the stock market set up their banks gaining licences from the State Bank once they met the requirements. Many banks, even after the boom years of 2002–07, continued to make phenomenal profits. 2011 was considered to be the 'most profitable year in their history', when 22 listed commercial banks had a combined profit of 84 per cent compared to 2010.[32] According to Farooq Tirmizi, 'Part of the reason for the blow-out increase in the sector's bottom line is simply the fact that the banks that were haemorrhaging losses last year are now turning profits. Yet, this is not the entirety of the picture. Many banks have simply grown at a dramatic pace, and sometimes seeing their

Box 14.4

The Profits and Losses of Pakistan's Banks: 2012

Farooq Tirmizi writes:

Is the party in the banking sector over or is it just getting started? While the State Bank of Pakistan recently took some actions that most analysts view as having a negative impact for the banks, for the most part, the record-breaking profits look set to continue for the foreseeable future.

The year 2011 has been an outstanding one for the banks. While the results are still being compiled for some, by most accounts, the commercial banks in Pakistan closed out the most profitable year in their history on 31 December 2011. The 22 listed commercial banks had a combined profitability of Rs. 117.5 billion, up an astonishing 84 per cent compared to 2010. Even when one excludes the banks that had losses in the previous year, the banking sector's profitability is still up a very respectable 27 per cent.

Part of the reason for the blow-out increase in the sector's bottom line is simply the fact that the bank that were haemorrhaging losses last year are now turning profits. Yet this is not the entirety of the picture. Many banks have simply grown at a dramatic pace, and sometimes seeing their profits double or triple.

Bank Alfalah, for instance, saw its profits rise by a massive 262 per cent, while Meezan Bank saw its profits rise by over 105 per cent. Even Standard Chartered Bank saw its net income increase by 54 per cent. So how did these banks do it?

It does not appear to be an extraordinary increase in the sector's deposits, which grew by about 14.6 per cent last year, which is about on par with the growth rate during the past decade. Nor does it appear to be an inordinate increase in the banking spread—the difference between the interest rate that banks charge their borrowers and the rate they pay out to their depositors. For much of the year, the spread hovered between 7.4 and 7.7 per cent, which is high but nowhere near record-breaking levels.

The real difference appears to have been the provisioning for loan losses, for which the banks appear to have taken most of their lumps in the preceding three years. Nearly every bank CEO who spoke to *The Express Tribune* spoke of how 'clean' their balance sheet was, a euphemism for having gotten rid of all of their bad loans.

There are still many experts who believe that the banks still have a lot to hide. The State Bank's relaxation of some provisioning rules, particularly for some banks, appear to be artificially inflating the bottom lines of many banks. Some have forthcoming about the weaknesses of their balance sheet. The Bank of Punjab, for instance, admits that it did not recognize losses of about Rs. 28 billion after it was granted an exemption from the central bank.

The real reason for the banking sector's lower losses on bad loans may simply be that they have stopped making them to the private sector. Nearly every bank reported a massive increase in its investments in treasury bonds—effectively lending money to the federal government, risk-free—and weak growth, or even declines, in their lending to the private sector. The State Bank appears to be unhappy with this laziness on the part of the banks, going so far as to say that 'the banks have ceased to function as financial intermediaries in the economy', in one of its most recent quarterly reports on the state of the national economy.

And in the most recent monetary policy announcement on Friday, the central bank announced that it wants the banks to pay a higher minimum rate of return on the nearly 15 million savings accounts in the country.

So will this actually reduce the banking sector profitability? Most analysts believe that the effect will be marginal, and more than offset by the fact that the bank will continue to have lower losses from bad loans. The party in the banking sector may not be sustainable, but it looks set to last for a while longer.

Source: Tirmizi, Farooq, 'The Bottom Line: Is the Banking Sector's Record Streak About to Snap?', *Express Tribune*, Karachi, 16 April 2012.

Shahid Iqbal presents another aspect of the profits and troubles of Pakistani banks. He writes:

Although the banking industry is in profit, a number of banks are in trouble and their existence is even under threat. Banking sources said nine banks were still facing acute problem of raising deposit which kept them far from reaching close to meet the minimum capital requirement set by the State Bank. These are mostly small and medium sized banks.

Bankers said their problem had deepened over the past four years because a major chunk of deposits had been held by large local or foreign banks.

The banking industry showed handsome profits last year and the first quarter results of this year were the same. Most of these profits were earned by five large banks and the rest by foreign banks and some medium sized banks. 'The State Bank has adopted lenient attitude towards the paid-up capital requirement not attained by at least nine banks and gave them space to either improve or merge with others,' a senior banker said.

Banks were required to raise their MCR to Rs. 23 billion which was slashed to only Rs. 10 billion. The banks are now required to raise their paid-up capital to Rs. 8 billion by 2011, Rs. 9 billion by 2012 and Rs. 10 billion by 31 December 2013.

The banking sector recently witnessed sudden movements regarding buying and purchasing activities. The HSBC, a foreign bank, wants to sell its Pakistan operations, while a fairly large local bank, Askari Bank, shows its inability to continue without strong backing. The State Bank has allowed due diligence for these two banks. A few more banks are also eyeing options of sell-off or merger with others. Bankers of small banks said economic situation and political insecurity had diverted deposits towards a few large banks, while offers for much higher return by small and medium sized banks were not attracting depositors.

The glut of deposits in large banks resulted in poor return to depositors. The State Bank last month forced the banks to pay minimum six per cent return on savings products.

However, the problem of about nine banks remained unresolved and their effort to improve deposits and paid-up capital have failed so far. Bankers said the banking industry's attractive profits were not enough for foreign banks to stay in Pakistan and wait for improvement in economy. Although foreign banks have been in profit, their size of profit is not large enough to force to them continue to work for better days.

The poor economic growth rate and energy crisis have eroded hopes for quick recovery of economy, leaving no option for competitive banks to remain in the field. Foreign banks have been curtailing their international operations as part of restructuring at home in the wake of financial crisis and now the debt crisis which trapped the entire European Union. 'We are not doing banking like the foreign banks or competitive banks do in the financial sector. We earn by investing in government papers which pay as high as 12 per cent,' said a senior official of a government-owned bank.

Source: Iqbal, Shahid, 'Banking Industry in Profit, but Some Banks in Trouble', *Dawn*, Karachi, 13 May 2012.

profits double or triple'.[33] One bank made a profit of 262 per cent! This has been the pattern for some years now. In 2010, in just the first half of the year, the profits of commercial banks had increased by 33 per cent, with the top 5 banks accounting for 80 per cent of the profits. Box 14.4 shows two sides of the story of profit, loss, and sustainability in the banking sector.

While the state of the banking sector in Pakistan does have some unsettled issues, there have also been some innovations. Branchless banking, for example, and mobile banking, have been introduced, and the microfinance sector has seen the emergence of five microfinance banks, even though the microfinance field in Pakistan is still limited. Nevertheless, some innovations in the banking sector seems to have taken place in Pakistan, although there are still many problems and issues which affect the sector—see Box 14.5 on small depositors. However, the biggest issue concerning the banking sector is the size and scale of the sector, an issue which cannot be ignored and to which we now discuss.

14.1.9 Excluding the Majority: Limited Access to Finance in Pakistan

The foregoing sections which deal with the banking sector discuss issues about its size, its role, and the trends therein. However, what is more important is the fact that while so much importance is given to the formal financial sector, actually a very small proportion of Pakistanis—only 14 per cent—interact in the formal sector and a huge majority, probably compromising of many of the most vibrant and dynamic sectors in Pakistan, is actually excluded. Financial deepening and the extent of the formal financial sector is actually quite limited.[34] Some key features of Pakistan's financial sector and how it actually operates will place in perspective the formal financial sector.

Around 14 per cent of Pakistanis have access to formal finance, while 40 per cent have no financial access to either formal or informal financial systems. The 14 per cent figure for Pakistan needs to be contrasted with other countries to get perspective of its relevance. In Bangladesh, for example, 32 per cent have access to formal financial institutions and as many as 48 per cent do so in India, and 59 per cent in Sri Lanka.[35] Clearly, Pakistan is far behind these countries. What is more interesting to note, although not unexpected, given the narrative described above after the privatization of the banking sector in Pakistan, is that only 25 per cent of the total bank deposits and 17 per cent of total borrowers live in rural areas. For a country which still relies on the agricultural sector, only 15 per cent of farmers are reached by any of the actors in the financial system, including commercial banks, agricultural banks, and other financial institutions.[36]

Forty per cent of the population is excluded from access to any type of financial services—formal or informal—a situation that needs to be explained. One of the modern myths about most things about Pakistan is that religious belief is an impediment. However, the *Access to Finance Survey* found that only 8.5 per cent of the population said that 'cultural' factors and religion were an impediment to their using financial services. As the Report says, 'religious reasons such as issues with paying or receiving interest, bank mistrust, and issues of corruption are cited by only 2.5 per cent of the non-banked'.[37] The informal financial market—which includes a vast array of actors including friends and family, shopkeepers, the committee system, and others—accounts for as much as 78 per cent of loans and total borrowing, a figure which is far higher than in other comparable countries. 'It is very common for poor people in particular to borrow from relatives, friends, and other people with whom they have close relationships, especially for consumption smoothing.'[38] From data from the Survey, it seems that almost everyone in Pakistan borrows, but a huge majority does so from the informal sector rather from formal sector institutions. Of all those who borrow, 97 per cent also borrow informally, whether it is from shopkeepers (77.9 per cent borrow from them), which is the most widespread form of borrowing), and around 53.5 per cent borrow from friends and family.[39]

As we have shown in Chapter 8, the small and medium enterprise sector and the informal sector play a key role in economic development in Pakistan. Of the 3.2 million enterprises in Pakistan, about 3 million (93 per cent) are of this nature. Most of these are in the wholesale and retail trade and include restaurants and hotels (53 per cent of this sector), and 27 per cent are other services, and with the manufacturing sector contributing the remaining 20 per cent of the small and medium-scale sector. Hence, these small units and enterprises constitute more than 90 per cent of all private enterprises, employ nearly 78 per cent of the

Box 14.5

Losing Small Depositors

Rauf Nizamani argues that while the profits of the banking sector may be growing, as we show, the incorporation of a greater number of depositors is not taking place and small depositors are being lost to the banking sector.

The State Bank of Pakistan has issued a series of instructions to banks over time to facilitate small depositors but their number is declining despite increase in bank branches.

The steps taken by the regulator to encourage depositors include:

* Banks shall not refuse opening of accounts for prospective clients who meet requirements laid down in Prudential Regulations, other instructions issued by the SBP from time to time, and banks' own policies.
* Services rendered by banks for the opening and maintenance of regular savings accounts shall be free of charge.
* There shall be no condition of maintaining a minimum balance for these accounts.
* No charges would be recovered by banks at the time of closing an account.
* Banks shall not demand more than Rs. 100 as an initial amount for opening of regular savings account.
* Banks shall pay profit invariably on Profit and Loss Sharing Accounts without any condition of minimum balance.

However, it has been observed that in recent years the number of account holders, in particular the number of small depositors, has declined.

Among other factors for this trend, the levy of service charges on deposit accounts is considered to be one of the main reasons. The banks have been paying higher rates of return on deposits of larger amounts. This has, to some extent, increased the average rate of return on deposits but the real beneficiaries have been big depositors. With a lower rate of return, small depositors are being discouraged. The total number of accounts of Rs. 10,000 or less which were 14.4 million on June 1999 reduced to only 9.3 million on 30 June 2004, showing a fall of 5.1 million accounts. This further reduced to 7.8 million on 30 June 2007 and 4.1 million in December 2011.

A 'mystery shopping expedition' conducted recently revealed that the minimum balances required to avoid penalty fees tend to be high. Moreover, although the initial deposit to open an account is substantially lower, banks usually demand Rs. 5000 (except for National Bank of Pakistan which demanded Rs. 1000). An exception was the Basic Banking Account [BBA] offered by the largest banks surveyed, but these accounts only allowed twice monthly withdrawals without penalties, while the low-income group prefers to access its funds at any time.

The large banks offering such accounts received the worst marks for information and service from the 'mystery' shopper. Although the private and foreign banks ranked better in terms of service, they failed to inform the 'mystery' shopper about BBA which all commercial banks are required to introduce under the SBP directive.

Currently, the commercial banks do not seem to be geared or inclined to serve the low-income groups. A look at geographical footprints and products confirms this. The banks' branch network is not well-distributed in the country from the point of view of providing services to the low income population. About 75 per cent of the urban adult population has a bank account as against only 14 per cent of the rural adults.

The large footprints of big banks make them prime candidates for mobilizing savings from low income population. These institutions hold more small deposits compared to other types of banks but need to do more. The relative ease with which these banks can mobilize large volume of funds means they are flush with liquidity and have little incentive to pursue the small depositors. Breakdown of branch and deposit data shows that the five large banks account for 69 per cent of the bank branches and 40 per cent of these are located in rural areas. The presence of these banks in rural areas is a legacy of bank nationalization era when it was mandatory to open two branches in 'un-banked' areas for every branch established in a banked area.

As four of the five largest banks have been privatized, they have rationalized their size, reduced staff, and closed down branches. Over 700 branches were closed between 1997 and 2000, of which over 330 were located in un-banked areas. This follows an all too common pattern in the post-privatization of financial institutions.

Rather than looking at improving the bottom line by increasing revenues, the focus is on reducing costs and hence branches in unbanked areas are closed and staff retrenched. The consequence of such restructuring is that people in the un-banked areas lose access to banking service and are forced to more costly informal sources. A better strategy to prevent shrinking access would be to increase the revenues of these apparently unprofitable branches through pricing for the so-called un-banked areas. Access to credit is a much bigger issue than pricing for those excluded from the net of formal financial services. They bear high costs in the informal sector.

Source: Nizamani, Rauf, 'Shrinking Numbers of Small Bank Depositors', Economic and Business Review, *Dawn*, Karachi, 13 August 2012.

non-agricultural labour force, and their contribution to GDP is over 30 per cent. Yet, out of these 3 million, only around 7 per cent borrow from the financial sector and account for only 16 per cent of total credit. These small and dynamic firms and units finance 90 per cent of working capital and 81 per cent of new investment from internal resources, retained earnings, and profit.[40] According to the *Access to Finance Survey* report, there are numerous business-unfriendly reasons why the small and medium sector is discriminated against. These include the 'legal framework (namely, the secured transactions regions and, to a lesser extent, the credit information structure) [which] limits the pool of potential applicants. Second, the bank products are not tailored to SMEs, resembling instead corporate lending practices. Finally,

banks do not have organizational structures and monitoring tools conducive to achieving high efficiency. SME demand-side factors, including limited SME accounting, budgeting, and planning capacity further constrain the market'.[41] If the most dynamic sector of Pakistan's economy is denied finances, something which Chapter 8 shows it desperately needed, then a 'banking sector' such as Pakistan's is certainly not doing something right. Moreover, as we saw in Chapter 6 earlier, once banks were nationalized by Bhutto in 1974, we saw a surge in financing of—and the subsequent growth in—the small and medium sector. Something is not working well in Pakistan's high-profit financial system.

14.2 The Equities Market

If an evaluation of the banking sector reveals that despite the claims of a dynamic and growing, as well as profitable, industry, supposedly playing its role in economic development, the banking sector actually only reaches a small fraction of Pakistanis, and excludes key and dynamic sectors, the truth, despite the headlines, about Pakistan's equity sector is even more embarrassing. On 13 August 2012, following an unexpected lowering of the interest rate by the State Bank of Pakistan, newspapers reported that the Karachi Stock Exchange Index 'surged' by 150 points to a 51-month high, the highest closing level since 2 May 2008. The market capitalization crossed $40 billion as a consequence. Since August 2012, well into September 2013, the Karachi Stock Exchange Index continued to break more records, reaching astonishing heights above 23,000. All this sounds quite fantastic given the exuberance of those who trade and deal with the stock market in Pakistan. But the very sober, indeed, extremely sobering truth is that the Karachi Stock Exchange, which became the worlds' best performing bourse in 2002 and 2008, had only 135,000 people actively investing in shares! No matter how many headlines the Karachi Stock Market index continues to make, it will affect a very small number of players, 0.01 per cent of Pakistanis—see Box 14.6. It has, of course, made many of those who traded—invested is not the right word—in the share market very, very, rich; but this just goes to show the logic and practice of Pakistan's equity markets.

Box 14.6

How Many People Invest in the Stock Market?

In the biggest stock market of the country, which made headlines by becoming the world's best performing bourse in 2002 and 2008, merely 135,000 people, or less than 0.01 per cent of the population, actively invest in shares, a fund manager revealed on Wednesday.

'If we compare this with around 30 million bank depositors in Pakistan, the Karachi Stock Exchange has not been successful to attract a substantial investor base,' said Dr Amjad Waheed, Chief Executive Officer, NAFA Funds.

According to analysis, the investor base is more or less stagnant for the past decade despite the fact that the KSE-100 Index, they key barometer of the market activity, has jumped by more than ten times since 2001. It crossed the psychological barrier of 15,000 points to make an all time high of 15,737 on 20 April 2008. 'We aren't comparing ourselves with the developed markets like the USA where every third person invests in stocks. Even India and Bangladesh have an investor base of 5 million and two million investors' respectively,' said one analyst.

Out of 270,000 investors in the stock market, gauged by the number of Unique Identification Number (UIN) in the Central Depository Company (CDC), more than half are inactive, Waheed said.

Waheed said the risk (standard deviation) of the Pakistani stock market, at 25 per cent, was much higher than other bourses in the region, which kept investors at bay.

'Partly it is because of the economic, political, and security leveraging and the speculative mindset of investors, who prefer short-term positions over long-term investments, are other factors that make our market more risky than others.'

He said that unlike other emerging markets, investments in Pakistan had been limited to a few large investors instead of millions of small investors.

'This is the reason why our stock market lacks the necessary depth and breadth, which is imperative for an efficient market.'

Waheed said that every stock market of the world had an option for investors to take leveraged positions in the market as these options provided the market with the necessary liquidity, which was important for price discovery and unfettered entry and exit for investors.

'All the leverage products, which include margin financing, margin trading, options, and futures should be available to investors, so that they might choose the one that suits their needs,' he said.

Talking about the option being considered by the Karachi Stock Exchange (KSE) and the Securities and Exchange Commission of Pakistan (SECP) of the margin trading product in which the investor would put 25 per cent equity in the form of cash, while the remaining 75 per cent would be provided by the financier and both the mark-to-market losses and concentration margins would be collected in the form of cash, he said that this product would provide better protection relative to the CFS MK-II.

Since the stock market crash of 2008, investors seem to have lost interest in the Pakistani stock maket. Average daily trading volumes have dropped sharply from around 212 million shares in FY07 to around 162 million shares in FY10.

The capital gain tax (CGT) on the stock market has further dampened the investors' sentiment, he said. 'The Pakistani stock market has been in existence for over six decades.

Despite the fact that the number of investors is miserably low and that this is because the confidence of masses in the stock investment could not be restored,' said Dr Amjad.

Source: Mirza, Javed, 'Less than 0.01pc invests in stocks', *The News*, Karachi, 5 August 2010

Of the three stock exchanges in Pakistan, the Karachi Stock Exchange (KSE) dominates, with more than 60 per cent of trading. Stock market activity has grown substantially over the last decade and the number of listed companies in Karachi rose from 300 in 1986 to 775 in September 1996 but fell to 689 in 2004 and to 589 in 2013. The State Bank of Pakistan General Index of Share Prices, which was 100 in 1990/1, rose to 290 in June 1994, registering a rise of 80 per cent since 1992/3. It fell considerably in the 1990s, especially after the nuclear tests in 1998 and then after 9/11; but then rose again and was 139 at end June 2002. By 2012, the Index was ten times its 1995 value. The capitalized value of shares increased by 88 per cent in 1994 compared with 1992/3 and was Rs. 404 billion in June 1994 but fell markedly throughout the 1990s, until the boom in 2003 when market capitalization had reached Rs. 1346 billion by March 2004. The value in turnover of shares increased three-fold between July 1993 and June 1994 but then stabilized until, once again, the stock market boom of 2003, when the turnover more than doubled in one year. When it came into existence in September 1947, the Karachi Stock Exchange had 90 members, but only 5 companies listed, and it had a paid-up capital of Rs. 37 million. By September 1996, it had 200 members of which 150 were active, and the 775 listed companies had a listed capital of Rs. 138.7 billion and a market capitalization of some Rs. 341.84 billion. All these numbers multiplied in the most recent, post-2012 boom.

Although the equity market seems to show phenomenal growth, a number of particularities need to be pointed out. While the Karachi Stock Exchange ranks amongst the top Asian exchanges in terms of the number of listed companies, Pakistan has one of the smallest markets in terms of market capitalization and trading volumes. Pakistani equities are a mere 1.6 per cent of the total for emerging markets. The average daily volume of the Karachi Stock Exchange in 2010/11 was 94.83 million shares, and the daily turnover fluctuates greatly. For instance, while it rose to 195.08 million on 13 August 2012, it was just 37.62 million in the previous trading session. In the calendar year 2011, the average daily volume of shares traded fell to a thirteen-year low, of 79 million shares, the lowest since 1998, giving an indication of the extent of volatility in the stock market, perhaps reflecting trends in the economy as well as in politics. Only four new offerings—IPOs—were floated in 2011, after six were offered in 2010, not many by any account of measure. About 300 equities are traded on an average day but trading in most shares is usually in insignificant volumes. Furthermore, trading in shares of only the ten best blue-chip companies is estimated to account for over 30 per cent of turnover in terms of value.[42]

The Karachi Stock Exchange (KSE) 100, having risen to a very high 2661 in March 1994 when the market experienced a boom, was then halved to a little over 1300 in November 1995. Moreover, for over a year after November 1995, the index showed little movement. It fell to its lowest level in July 1998, at 765.74, following Pakistan's nuclear tests—see Chapter 18. It subsequently rose to unprecedented levels, breaking all previous records, when in April 2004 it crossed 5,620. Some of the reasons for this trend are given in Box 14.7 and in Box 14.8. Subsequently, it touched the 15,000 level as well, for the first time in 52 months, crossing 23,000 in 2013.

The boom of March 1994 was caused by the large public offerings made around that time, including key companies such as Pakistan Telecommunications Corporation (PTC), Hub Power, Faysal Bank, Lucky Cement, Dhan Fibres, and Ibrahim Fibres. Consequently, no fresh capital was left for secondary markets. Another factor that undoubtedly affected the performance of the stock market was the law and order situation in Pakistan. In more recent years, the economic situation, political uncertainty, even US-Pakistan relations, and other such factors have affected the performance of the stock market. Furthermore, despite attempts to make the stock market an effective institution so as to raise funds for industry, much of the activity on the Karachi Stock Exchange has been speculative (see John Maynard Keynes' somewhat cynical views on the stock market in Appendix 14.3).

Although efforts have been under way to reform it, the stock market is not perceived by most investors to be either efficient or fair. Insider trading, front running, cornering of shares, and excessive speculation are perceived to be endemic. A Securities and Exchange Commission exists to provide a better regulatory framework for overseeing the workings of the markets. If the market is expected to work more efficiently, speedier implementation and efficient and timely information need to be provided to investors, particularly foreign investors. Better disclosure rules about the activities of corporations are also essential. Other concerns relate to the fact that investors do not have access to preference shares, a procedure discontinued in 1984. Aftab Ahmed Khan presents a large number of reasons why the stock market has not grown as many expected it to—see Box 14.9. (Also see Box 14.10 for quite a brilliant analysis undertaken by Asim Khwaja and Atif Mian which shows how dealers on the Karachi Stock Market manipulate prices and profit).

As far as sources of equity are concerned, the bulk of the shareholding is by the sponsors themselves (60–65 per cent), individuals hold about 15–20 per cent, foreigners hold 3 per cent, and the balance is held by institutions. On the other hand, institutions such as NIT, ICP, and *mudarabahs* account for as much as 50 per cent of market volume, with individual investors and brokers accounting for almost all the rest.

The stock market is also affected by the fact that the settlement of shares involves a cumbersome procedure for share transfers and registration, and the physical handling of shares seriously affects trading volumes. Antiquated stock practices favour the informed investor and are biased against the small investor. The risk of non-delivery and non-payment and the high cost per transaction also restrict the access of small investors to the market. The lack of transparency and credibility of information affects the development of a modern financial system. It is also believed that a central depository system is needed to eliminate the numerous problems caused by the physical handling of securities. Despite shifting to electronic means of trade and regulation, the Karachi Stock Exchange is still not considered to be a mature equities market.

Conventional wisdom in Pakistan, in line with the extensive liberalization, deregulation, and privatization that has taken

Box 14.7

Factors Behind the Fall in the KSE Index

The following extract is an analysis of the peaks and valleys of the KSE 100 index between 1991 and 1996.

The KSE 100 index came into existence in November 1991 and the amount of foreign money entering the market increased sharply in June 1991 after the enactment of the Foreign Exchange Controls Act and other financial reforms and liberalization programmes. If we take a look back at the previous peaks and valleys of the KSE 100 index and the stock prices of selective index and blue-chip stocks, the poor conditions of the current market can be rationalized.

The first peak was on 6 January 1992 when the index reached 1714. The market in 1991 was small and relatively inactive and thus many blue-chip stocks were undervalued. However, with increasing activity from both local and foreign investors because of the reforms, the stock prices rose across the board, especially in the textile and *modaraba* sectors. The average daily turnover at this time was around 2.5 million and the market PE rose from 10x in November 1991 to 15x. The boom of 6 January 1992 reflects the results of the introduction of financial reforms and liberalization policies. With any boom, there is always a correction.

After reaching 1714 in early 1992, the index dipped to 1084 on 24 April 1993, a correction of 37% within 15 months of the last peak. The circumstances surrounding this fall are mostly political due to the dismissal of the sitting government at that time. The reaction to the dismissal amongst investors and the business community was negative and thus reflected in most of the share prices. The market PE fell to below 10x and the average daily turnover was 3.2 million shares. Share prices of banks, synthetics and rayon, and fuel and energy stocks reacted negatively while chemicals and pharmaceutical stocks felt little or no effect from the slide in the index.

One of the reasons why the chemical and pharmaceutical sector may have been immune to the bearish sentiments at that time could be because of the nature of the shareholding and history of good dividend payouts. The shares of multinational pharmaceuticals are closely held by the parent or by strong holders and, thus, are not the most active scrips on the market while other stocks are more widely held and may be in the possession of weak holders ready to sell in a panic in the face of adverse conditions instead of holding on to the shares.

The next important point is 22 March 1994 when the index had reached the historic apex of 2661, a rise of 145% from the previous low of 24 April 1993. In the aftermath of elections held during October 1993 and the formation of a new government, there was an euphoria in the market as investors breathed a sigh of relief as political stability was achieved. There was fresh capital injected into the market as both local and foreign investors entered the market in a big way. The gains were phenomenal as most stocks rose 3 to 4 times their prices as of 24 April 1993.

Also, many sectors such as synthetic and rayon and cement had positive fundamentals which were looked upon favourably by most investors. The market PEx more than doubled from the low point of 1993 to over 20. Also, average daily turnover doubled to 7.7 million shares. However, since 22 March 1994, the index has been continuously declining and has not surpassed the historic peak of 2661.

Source: Sheikh Humayun Saghir, 'Factors Behind the Fall in the KSE Index', *DAWN*, Advertising Supplement, 30 September 1996.

place in the financial sector and other areas of the economy, believes strongly that the stock exchange has a role to play in industrialization and development (see, for example, Appendix 14.2). However, not only does this view ignore the experience from other countries, as shown in Appendix 14.4, but it also does not adequately examine the recent trends in the securities market in Pakistan. With only a handful of companies' shares being traded regularly and despite the large number of shares ostensibly changing hands each day, the role of the stock market is currently very limited in the context of Pakistan's growth strategies. *Its role is almost entirely of a speculative nature*, with many individuals making and losing fortunes. However, given the worldwide wave of interest in emerging markets and the mushrooming on the fund managers' map of potential and new stock markets, it is probable that Pakistan's stock exchanges will continue to be of interest to local and international investors.

After General Musharraf came to power in October 1999, there was a huge surge in stock market indicators to a nearly 3-year high in February 2000. However, after reaching this high, the Karachi Stock Exchange index started to fall again and continued to fall through the 9/11 period. It started its strongest rally from around the July 2002 period, right through into early 2004, when it broke almost every record—turnover, volumes, index levels, etc.—which it was setting at a regular period. There was a huge unprecedented stock market boom in Pakistan, and the Karachi Stock Exchange was heralded as one of the best performing stock exchanges in the world in 2002/3 and again in 2008.

While the index and turnovers did break many records, some weaknesses in the capital market were accentuated in the course of these giddy heights. The most noticeable was that of Initial Public Offerings (IPOs) which depict new company listings on the stock market. In the three-year period 1993–96 when the stock market was maturing, there were 147 new companies listed on the Karachi Stock Exchange, 93 on the Lahore and 117 on the Islamabad Stock Exchanges. However, in the next boom period after 1999 till 2003, only *ten* new IPOs were offered on the Karachi Stock Exchange and even fewer on the Islamabad and Lahore exchanges. Clearly, one must question the irrational exuberance of investors on the Karachi Stock Exchange, since it is unlikely that the fundamentals have improved that much—see Chapter 18.

Box 14.8

KSE and Home Remittances

On 12 October 1999, the Karachi Stock Exchange's share index stood at 1,256.94 points. On 11 September 2001, it was at 1,255.98 points.

On 11 September Osama bin Laden rolled his dice. A month later, President George W. Bush brought in the Patriot Act (the US Senate passed the USA Patriot Act on 11 October 2001). The Act 'vests the Secretary of the Treasury with regulatory powers to combat corruption, foreign money laundering, close our borders to foreign terrorists and to detain and remove those within our borders'. At the receiving end of the Act were Pakistanis settled in the US and *hundi* operators out of the Middle East. Pakistanis settled in the US began sending their savings back while hundi operators began losing business to official banking channels.

In 1999–2000, Pakistani-Americans sent back a meagre $80 million. Between July 2002 and February 2003 the remittances from America amounted to a colossal $856 million, Remittances from Canada, Germany, Japan, Kuwait, Norway, Qatar, Saudi Arabia, Oman, the UAE, the UK, and the US put together have gone up from $983 million in 1999–2000 to $4.2 billion in 2002–03.

On 11 September 2003, the KSE's 1000-share index sat rather uncomfortably at 4,591.79 points, an appreciation of more than 250 per cent since that fateful September day of 2001. That made the KSE, the best performing index on the face of the planet.

The accompanying graph captures both the movement of the index and the volume of home remittances over the last four years (if we had a real estate price index its movements would have probably traced home remittances as well).

In October 1999, foreigners sold Rs. 410 million worth of Pakistani shares and did not stop selling for at least two more years. The largest disinvestment of Pakistani shares by foreign holders came in 2001 when they sold off Rs. 8,385 million worth of Pakistani stocks.

There is little magic and no secret. The KSE boomed because there was too much expatriate money chasing a stagnant pool of capital stock (the number of companies listed on the KSE has gone down from 756 in 1999 to 700 in 2003, while the accumulated listed capital has moved from Rs. 223 billion to Rs. 304 billion over the same period). Foreign investors have shown little or no interest in Pakistan. It has essentially been a technically driven rally.

The inflow picture may now be changing. Our three largest sources of expatriate inflow have been the US, the UAE, and Saudi Arabia. In 2000–01, Pakistani-Americans sent back $134 million. The following year the inflow from the US went up to $779 million, a wholesome 480 per cent. A year later, there was another jump but a more moderate one; from $779 million to $1,237 million or 59 per cent. In September 2002, Pakistan got $124 million from Pakistani-Americans while in September 2003 the same had declined to $97 million or a drop of more than 21 per cent. In July–September 2002–3, inflow from the US was $330 million declining to $258 million in July–September 2003–04; a drop of 22 per cent.

Here's the record for the UAE in 2000–01, $190 million followed by $469 million and then the following year $837 million. In percentage terms the first increase amounted to 146 per cent followed by a more moderate increase of 78 per cent. In July–September 2002–03, the inflow from the UAE was $262 million declining to $146 million in July–September 2003–4; a drop of 44 per cent (from Saudi Arabia, inflows have more or less followed past trends of between $350 million to $500 million).

The three conclusions that stand out are: first, the bubble at the KSE (and the property market) has an almost perfect correlation to home remittances; second, home remittances—at least from the US—are a consequence of Osama and the Patriot Act; third, the overall volume of home remittances is tapering off.

Source: Farrukh Saleem, Economic and Business Review, *Dawn*, Karachi, 27 October–2 November 2003.

Further, research by Fazal Hussain and Tariq Mahmood shows that the stock market is not a significant factor to influence aggregate demand in Pakistan, and nor can it be 'characterized as the leading indication of economic activity,', as governments, such as the Musharraf-Aziz government claimed whenever the stock market was doing well. Hussain and Mahmood argue that the stock market logs economic activity, and that 'individuals, institutions, and government should be aware of speculative bubbles. In the absence of other strong economic indicators, shooting up of stock prices should be dealt with care'.[43]

Given the distorted nature of the Pakistan stock market, not reflecting in any way changes in 'fundamentals', it is a far cry from the efficient markets hypothesis. The belief that the stock market in Pakistan is an indicator of economic development and progress, and reflects government policy and initiative, is quite erroneous. For this reason, despite the enthusiasm for 'investing' in the stock market, the contribution that this investment will make to real economic growth, is largely cosmetic—also see Boxes 14.11 and 14.12.

14.3 Summary and Further Reading

14.3.1 Summary

The banking sector and the stock market form the focus of this chapter, the first of two chapters on the financial and monetary sector of the economy. We have shown how, from a non-existent banking sector, the financial sector has emerged as a key component of the economy, but still excludes a majority of the people. The history of banking shows that industrialization and economic development are closely linked with the development of the banking sector. We have highlighted the numerous problems that afflict public sector banks. The fact that nationalized commercial banks had an infected portfolio equivalent to 6 per cent of GDP affects their

Box 14.9

The Weakness of the Stock Market

Pakistan's stock markets suffer from numerous problems. Some are identified here.

The retarded growth of equities markets in the past has been due to a variety of factors, of which the following are significant:

(a) Public companies and public sector enterprises were not encouraged to list on the stock exchange because government interest rate and credit allocation policies distorted the price structure of equity finance relative to loans from financial institutions and other sources. This stimulated excessive reliance on debt financing and led to high debt–equity ratios.

(b) Public enterprises received funding directly from the government either through appropriations from the national budget or at relative low interest rates from state-controlled financial institutions.

(c) The majority of private sector firms have tended to be relatively small and consequently their needs have tended to be modest, mainly confined to meeting working capital requirements. The firms have been able to generate the required finances from personal loans and their own contributions and retained earnings as well as short-term loan facilities from commercial banks.

(d) There is a strong concern among private company owners regarding the dilution of ownership and control of their firms. Most owners wish to keep the benefits of their entrepreneurship and control over the future of their enterprises within a limited circle of relatives and friends. Even when a company is listed on the stock exchange, most of the shares are not available for public trading.

(e) A number of companies are reluctant to disclose information about their financial status. The disclosure requirement has been instituted to protect the interests of the investors.

However, since most of the private companies do not have to submit externally audited financial statements, they are better able to evade taxes in some way. The public listed company is placed at a disadvantage relative to its competitors.

(f) As a result of factors such as after-tax returns, risk, and liquidity, other instruments offered higher yields and less risk than securities.

(g) Investors have generally felt that the market can be rigged against anyone but the largest investors. There is trading on the basis of privileged information involving considerable unacceptable risk for the small investors.

(h) Institutional investors such as investment companies, unit trusts, pension funds, and insurance companies have played a limited role in the development of the share market. The active participation of institutional investors is critically important for the development of the equities market.

(i) There is a lack of appropriate financial information regarding the stock market. Of all the financial markets, the stock market is the most difficult to comprehend.

Source: Khan, Aftab Ahmad, *DAWN*, Economic and Business Review, November 1994.

performance, and also has negative impacts on the rest of the financial sector and on the economy.

Although there has been a scramble to establish stock markets in most developing countries, the positive impact of such investment is, for Pakistan, still a long way off. The stock market is not seen as a mechanism to raise capital and we find no reflection in stock market behaviour of changes in 'fundamentals'. Rather, the stock market in Pakistan is more like a small club, where just a handful of companies dominate the market, and just a few players call the shots. The claim that underdeveloped countries should develop stock markets at the expense of other sectors is questionable. Experience from other countries has shown that other means of raising revenue for economic development are perhaps better suited to the current needs of Pakistan.

14.3.2 Further Reading

Unfortunately, there is very little reading to recommend on either the banking sector or the equities market in Pakistan, because very little published material exists. On the financial sector, there is the excellent and informative history of the State Bank of Pakistan, published so far in three volumes by the Bank, and the book written by S. A. Meenai, (revised and expanded by Javed A. Ansari) *Money and Banking in Pakistan* (Karachi: Oxford University Press, 2001). The *Journal of the Institute of Bankers in Pakistan* contains analysis of and articles on recent developments in the financial sector. The State Bank's *Annual Report* is also a good source about yearly developments. Newspapers often carry reports and analysis on a regular basis, and should be consulted frequently. The State Bank's *Pakistan: Financial Sector Assessment 1990–2000*, is also a useful volume which traces the history of the reforms that were made that decade.

Box 14.10

Price Manipulation in the Karachi Stock Exchange

This extract from a brilliant paper by Asim Khwaja and Atif Mian brings out a factor which contests the claim that stock markets in developing countries have much to do with 'fundamentals'.

Most emerging economies have relatively young and weak market-based financial institutions such as stock markets. The influential view is that in the presence of weak regulatory and contractual enforcement small investors are deterred from investing in the stock market. There are a couple of reasons suggested for this: First, poor corporate governance of firms leads to tunnelling and revenue hiding. Second, outside investors stay out of the market for fear of being exploited by unscrupulous stock price manipulators and insider traders.

This paper addresses this gap by analysing a unique data set containing *all daily* trades of *each* broker in *every* stock trading on the Karachi Stock Exchange (KSE)—the main stock exchange in Pakistan. The high level of disaggregation in the data not only allows us to examine broker behaviour in great detail and relate such behaviour to profitability, but also identify mechanisms through which brokers may be systematically beating the market. We provide compelling evidence that price manipulation is one such mechanism. In fact, we are able to isolate a *particular* price manipulation mechanism through which brokers cheat the naive outside investor: when prices are low, colluding brokers trade amongst themselves to artificially raise prices and attract naive positive-feedback traders. Once prices have risen, the former exit leaving the latter to suffer the ensuing price fall.

Anecdotal evidence suggests that such manipulation in stocks is carried out by brokers who primarily trade for themselves in these stocks. We find that such behaviour is quite pervasive among brokers in our data set. There are a surprisingly large number of brokers who appear to only trade for themselves and, while such a broker does not do so in all the stocks he trades in, almost all stocks do have such 'principal' brokers. Our main finding is that these principal brokers who trade primarily on their own or for a few investors in a given stock earn significantly higher returns than those who act as intermediaries in that stock. The difference in returns is both statistically and economically highly significant. The annualized return on trades done by principal brokers in a stock is 4 to 8 per cent higher. We interpret this as the difference in profits between brokers who trade directly for themselves in a stock, and the outside investing public that trades through brokers acting as intermediaries in that stock. The result does not depend on inherent broker attributes. We also test the robustness of this result to different specifications and measures of the 'principalness' of a broker and find that the effect remains significant and large.

The difference in profitability begs the question: What do principal brokers know or do that the outside traders are unable to? A closer look at trading patterns of brokers reveals some 'strange' and pervasive patterns, such as heavy and rapid back and forth trading of a stock by the same pair of brokers. Such trading patterns, coupled with the persistent anecdotal evidence from market observers, suggests that price manipulation by brokers is one of the primary suspects in explaining the return differential.

We indeed find strong direct evidence for such price manipulation in the data. On days when the stock price is relatively low, most of the trade—both buys and sells—is done by brokers who act as principals in the stock, while on high price days, most trade is done by outside traders. Moreover, the characterization of trading days by who is buying and selling has strong predictive power for future returns. The pattern and direction of these predictive returns match perfectly with a price manipulation model where brokers constantly take advantage of naive outside positive-feedback traders: Weeks in which mostly principal brokers buy *and* sell stocks to each other have low relative prices followed by positive returns. This attracts the outside traders to trade, which further boosts up the prices. However, by the time prices have reached a relatively high point, most principal brokers have sold out of the stock. At this point only the outside traders are left to trade among themselves. The presence of mostly outside traders on both the buy and the sell side therefore predicts negative future returns. As prices keep dropping, the principal brokers slowly buy back their stock at lower prices. The cycle then repeats itself with principal brokers once again raising prices by buying and selling the stocks back and forth to one another. We therefore argue that our finding is consistent with the price manipulation theory and cannot be attributed to broker ability, institutional features, or factors such as liquidity.

The next question is how this return differential between principal broker trades and outside trades in a stock varies *across* firms of different types. Such an analysis can help us understand what firms are more susceptible to manipulation than others. We find that the return differential is smaller, though still positive and significant, for stocks of larger firms, and firms with higher concentration of stock holdings. We also see that for a given stock, a higher return differential between principal broker and outsider trades is correlated with higher stock price volatility. This suggests that it is the manipulation of prices that leads stocks to have higher price variability, and higher return differential at the same time. Finally, while the higher profitability of trades by principal brokers is not due to inherent broker attributes, we do find that *more* 'able' brokers earn *higher* returns when they decide to trade as a principal in a stock with ability defined as the average profitability of trades done by/through a broker in *all* stocks.

Source: Khwaja, Asim and Atif Mian, 'Price Manipulation and 'Phantom' Markets: An in-depth exploration of a Stock Market', *Mimeo*, February 2003.

Box 14.11

The Karachi Stock Exchange: Still Struggling Despite Growth

Shahid Shah evaluates the status of the Karachi Stock Exchange and despite phenomenal rises in the Index in 2012 and 2013, explains why the KSE still falls short of all significant measures of achievement.

The Karachi Stock Exchange is struggling to regain its glory days in international capital markets but the chances of such an occurrence in the near future are slim, according to one stock market official.

The KSE official, who requested anonymity, said that the stock market was a member of an exclusive club of mid-tier markets called emerging markets from 1994 onwards but lost the status after the stock market crash in 2008 and was subsequently downgraded to a lower tier of markets called frontier markets.

Markets in this category typically suffer from multiple afflictions, such as low liquidity and political uncertainty, which keep all but the most fearless investors away.

In June this year, the United Arab Emirates and Qatar were reclassified after index compiler MSCI said it would include the two countries in its emerging markets benchmark effective November 2014—a move that will boost investor sentiment and attract foreign investment inflows into the region.

Pakistan failed to qualify for a reclassification again in the latest annual review of the MSCI announced on 11 June despite a rise of over 100% in the benchmark index of the Karachi Stock Exchange since the start of 2012. MSCI reviews the markets in June and November every year.

The MSCI's emerging markets index consist of 21 countries, including China, South Korea, Brazil, India, and Taiwan, while there are 25 countries in the frontier markets index.

There are numerous criteria against which the MSCI measures market accessibility in a given country before categorizing it in the emerging markets index. One of the requirements include that the market aiming to be reclassified must contain at least three companies which have a free-float capitalisation of $898 million each.

The top nine companies in Pakistan's market contributed to a total market capitalisation of $5,259 million but their free-float remained below the MSCI requirement. The average market capitalization of the top nine was around $584 million and the average around $175 million only.

Pakistan's top nine companies included Oil and Gas Development Company Limited (OGDCL), MCB Bank Ltd, Fauji Fertilizer Co, Pakistan Oilfields, United Bank, Hub Power Co, Pakistan Petroleum Limited, Engro Corporation, and National Bank of Pakistan.

The current weights of Qatar and UAE in the MSCI Frontier Markets Index are 16.8% and 12.4% respectively, while Pakistan's weight in the MSCI Frontier Markets Index is 4.94%. "There is no upper limit of weight in the index," said one official of the KSE.

The MSCI's decision not to elevate Pakistan from the Frontier Markets Index to the Emerging Markets Index surprised many stock analysts, who were anticipating an upgrade based on the country's improved liquidity and strong net foreign inflows.

According to one official, MSCI officials verbally communicated to KSE officials that an upgrade to emerging markets was not possible at this time because the country's capital market was volatile and the free-float of potential companies was on the border of frontier and emerging markets with a decline possible at any time. However, Pakistan is still preparing its case and will keep pursuing the matter, sources in the KSE said.

KSE Managing Director Nadeem Naqvi said that MSCI's criteria had nothing to do with politics and, even if that was so, MSCI had not communicated anything regarding Pakistan's political situation to them.

"I am disappointed that Pakistan was not included in the emerging market index from its current status of frontier markets despite fulfilling all technical requirements," he said.

MSCI also believed that the newly formed government would likely tackle controversial issues on the political and economic fronts, which would negatively affect the stock market.

The downgrade in 2008 to the frontier markets index led to huge losses in liquidity and a decline in the free-float capitalization, which subsequently led to a declining number of shares being traded and small investors abandoning the market altogether.

Karachi Stock Exchange achieved a major milestone when KSE-100 Index crossed the psychological level of 15,000 for the first time in its history and peaked 15,737.32 on 20 April 2008. Moreover, the increase of 7.4 per cent in the first four months of 2008 made it the best performer among major emerging markets.

However, record high inflation in the month of May 2008 led to an unexpected increase in interest rates by State Bank of Pakistan which eventually resulted in a crash in July when the KSE-100 benchmark index shed a third or more than 5,000 points from an all-time high in April 2008. In December 2008, Pakistan was removed from the list of emerging markets.

All other emerging and developed markets including India (emerging), US (developed), and Europe (most of the countries developed) were ahead of Pakistan on the basis of huge free-float market capitalization in their markets.

"When the free-float of companies is low in the market around 20 to 25 players can easily manipulate the market index," said a KSE official.

He went on to add that even public sector giants in the stock market such as Pakistan State Oil and Oil and Gas Development Company Limited had very little free-float in the market. "Pakistan Petroleum Limited participation is also very low," he said.

Zafar Moti, a senior member of the KSE commenting on Pakistan's index status said though Pakistan's index downgrade was not celebrated, it proved to be a blessing in disguise as foreign investment arrived in the KSE. "Foreign fund managers have priorities; some invest only in frontier markets while others in emerging or developed markets," he said. Moti said that Pakistan held weight in the frontier market index, securing a good share of investment by foreign fund managers.

"On the other hand, it would face tough competition in the emerging market index with a smaller share in the foreign portfolio investment."

The KSE official also agreed that market was receiving more foreign investment under frontier markets index but insisted that the KSE members eagerly wanted to satisfy their egos by moving in the emerging markets index, a status they had successfully retained for almost 15 years.

Shah, Shahid, "Emerging market status to remain elusive for Pakistan', *The News*, Karachi, 28 June 2013.

Box 14.12

The Underbelly of Pakistan's Stock Market's 'Extraordinary' Growth

Pakistan's chaotic financial heart is home to 18 million people, Taliban bombers, contract killers—and one of the world's most successful stock markets.

With 49 per cent returns in 2012, the Karachi Stock Exchange (KSE) was one of the five best performing markets in the world. Now it is seeking a foreign partner to buy a stake and takeover management of a market that has risen three-fold over the past four years.

At least some of that performance came on the back of a government amnesty that allowed people holding undeclared assets or 'black money' to invest it freely in the market. And the relatively illiquid market has also been vulnerable to manipulation.

But government officials say the market's success highlights the economic potential of a country better known for spiraling sectarian violence, the war against al Qaeda and the Taliban, crippling power cuts, and entrenched corruption.

The market's benchmark index continues to soar to record highs—up 10.34 per cent year to date—fueled in part by expectations May elections will mark Pakistan's first transfer of power from one democratic government to another. For foreigners, a 7.6 per cent depreciation of the Pakistani rupee against the dollar in 2012 and another 1 per cent since the start of the year has offset some of those gains.

'Pakistan has a lot to offer investors and this is our chance to show it,' said Nadeem Naqvi, the KSE chairman. He plans to embark on a series of roadshows for potential foreign partners that will take him to London, Frankfurt, and Hong Kong in the coming months.

Many of the companies listed on the KSE offer double-digit returns, low stock prices, and resilient business models in this frontier market with a population of 180 million. The index still has an attractive price/earnings ratio of $8.50 despite the soaring returns of the past few years.

Pakistan now has a 4 per cent weighting in the MSCI Frontiers Market Index and has become somewhat of a discovery for foreign investors chasing new markets and yields.

THE SEAMIER SIDE

But the KSE's spectacular rise last year can at least be partly attributed to another factor entirely—the cleansing of 'black money'.

The market took off last year just as a government decree was finalized allowing people to buy stocks with no questions asked about the source of the cash. Average daily volume more than doubled last year to 173 million shares from 79 million in 2011.

Authorities say the measure will bring undocumented funds into the tax net in a country where few pay taxes. But some critics decried it as a gift to corrupt officials and criminals seeking to launder dirty cash.

'Politics and dirty money go hand in hand in Pakistan,' said Dr Ikramul Haq, a Supreme Court lawyer and a professor on tax law.

'People want to be outside the regulatory framework and outside the tax net.'

The black money amnesty also drew attention to the seamier side of the Karachi stock market. Interviews with regulators, brokers, market officials, and analysts showed insider trading and other manipulations are routine. Regulators have been largely ineffectual in controlling the shady practices.

The Securities and Exchange Commission of Pakistan (SECP) said it found 23 violations of securities laws that merited fines in fiscal year 2011–12 (April/March). The market regulator sent warning letters in another 19 cases, it said in its annual report. (www.secp.gov.pk/)

That's a drop in the bucket, says Ashraf Tiwana, dismissed as head of SECP's legal department after years of clashes with his bosses over fraud in the market. He has petitioned the Supreme Court to replace the SECP chairman and commissioners.

'There's a lot of fraud, a lot of market manipulation . . . but not enough action has been taken, especially not enough criminal action has been taken,' Tiwana told Reuters. 'They're just passing small fines and giving out warning letters.'

Regulators are too close to the market, Tiwana said. The head of the stock exchange is a former broker and the two top members of the SECP are former employees of Aqeel Karim Dhedhi, founder of one of the country's biggest brokerage houses.

BIG DHEDHI

Nicknamed 'Big Dhedhi' for his ability to move markets, Aqeel Karim Dhedhi heads one of Pakistan's largest domestic conglomerates, the AKD Group (AKDC.KA).

Lately, the well-known philanthropist and leading member of Pakistan's business establishment has been trying to fend off arrest over allegations of insider trading.

An SECP investigator accused traders, including Dhedhi's brokerage, of buying shares in a state-run Sui Southern Gas Co (SUIS.KA) before an official announcement allowing the company to raise its prices. In the weeks before Sui Southern's announcement, the stock price jumped from Rs. 13.5 to Rs. 20, its biggest hike in five years.

The National Accountability Bureau, the state-run anti-corruption agency, called it a case of insider trading. But the SECP said its own confidential investigation showed no evidence of fraud. The SECP whistleblower in the case has been suspended from her job for disclosing 'confidential information'.

Dhedhi strongly denied any wrongdoing and said he purchased his gas stocks years before the announcement.

'There is nothing there. The (SECP) report totally cleared us,' said Dhedhi, a burly man wearing a traditional long cotton shirt and baggy pants. 'I'm proud to say that in more than 40 years of operating, we've never paid a penny in fines.'

Dhedhi says he often offers advice to government officials on financial policy. His business empire includes two equity funds that were among the best performing in Asia in 2012.

'The SECP has really started listening to the market,' Dhedhi said, a suited executive acting as translator.

REVOLVING DOOR

Dhedhi remains under investigation. But even if regulators were to find him guilty of insider trading, past practice shows he would likely get a slap on the wrist. The SECP's fines are almost

always a fraction above the amount of money made in the stock manipulation, and sometimes even less.

In December, a broker was fined half the amount he made from trades that manipulated the share price of tobacco giant Philip Morris (PHIM.KA). In February, the SECP fined Pakistani brokerage BMA Capital $500,000—after it made $460,000 by misleading a foreign client. BMA Capital has appealed.

Imtiaz Haider, the SECP commissioner in charge of market regulation, acknowledged fines were largely symbolic. If they were too high, he said, brokers might not be willing to pay them. Contesting fines in the congested court system could take years.

'The purpose is more to name and shame,' Haider said in an interview. 'It causes them reputational damage.'

Like KSE Chairman Nadeem Naqvi, Haider is a former employee of Dhedhi's. Both men denied any conflict of interest.

'It's important to have people in charge who know the way markets work,' Haider said. 'I've had lots of other jobs than just working for Dhedhi.'

The SECP can revoke licenses, impose hefty fines, or open criminal cases against offenders. But it almost never does. It has launched only 10 criminal cases in the past five years—all still held up in the judicial backlog. It has issued dozens of small fines.

'We have great laws and regulations but they are not properly enforced,' said Khalid Mirza, a former SECP chief. 'The SECP is just catching the small fish as far as I can see.'

Naqvi, the KSE head, acknowledged his priority has been to boost the market, not to crack down on it.

'My management style isn't confrontational because I want to build confidence in the market,' he said.

Separating the commercial and the regulatory functions of the market is one of the main reasons the KSE is looking for a foreign partner. It has appointed Deutsche Bank as its advisor on its quest to demutualize—a process that will separate those two functions.

'Demutualisation is another step on the road to reform,' Naqvi said. 'Right now we have a fairly robust system. But I'm not saying its foolproof.'

BLACK TO WHITE

The Karachi market's small size and lack of liquidity make it vulnerable to manipulation. Market capitalization is only $41.5 billion—the Bombay stock market's capitalization is more than 10 times higher at $578 billion.

Only a quarter of the shares are freely floated—about 30 per cent of that is held by foreign funds and investors, including Franklin Templeton, Invesco Ltd, Goldman Sachs Asset Management, and Mackenzie Financial Corporation.

Since only 60 of KSE's 600 listed companies trade regularly, small trades can rapidly make a big difference in a company's share price.

Boosting volumes on the exchange was one of the intentions behind Pakistani President Asif Ali Zardari's decree last April turning black money into white.

It said no questions could be asked by the Federal Board of Revenue about the source of funds invested in stocks till July 2014. The investments become legally legitimate.

The pool of such funds is potentially huge. A report by the United Nations Office on Drug and Crime projected the size of Pakistan's informal or 'black' economy at $34 billion in 2010–11, one-fifth of the formal economy.

The Paris-based Financial Action Task Force, which monitors money laundering, said the decree did not contravene Pakistan's existing anti-money laundering legislation. But anecdotal evidence suggests controls are lax.

In one case shown to Reuters by a lawyer, a man invested $10 million buying stocks in a single transaction. His address: a Karachi slum notorious for Taliban infiltration

Source: Houeld, Katherine, 'Pakistan's booming market no black and white matter', Reuters, 12 April 2013. http://in.reuters.com/article/2013/04/12/pakistan-stockmarket-corrected-update-1i-idINDEE93B04R20130412

Appendix 14.1

The Nature and Significance of Capital Markets and Commercial Banks' Role in their Development

Some salient issues in the capital market and financial sector in Pakistan are described in the following extract.

> The capital market includes the portion of the financial system involved in (i) mobilization and intermediation of private savings, and (ii) allocation of medium and long term financial resources through a variety of debt and equity instruments of both private and public sector investment.
>
> Capital markets play a crucial role in mobilizing domestic resources and channeling them efficiently to the most productive investments. The level of capital market development is thus an important determinant of a country's level of savings, efficiency of investment and ultimately of its rate of economic growth. An efficient capital market can also provide a range of attractive opportunities to both domestic and foreign individual and institutional investors.
>
> A developed capital market usually comprises savings facilities, banking system, financial institutions for industry, primary and secondary markets where bonds and equities are traded and issued, an underwriting system, and an official regulatory authority to supervise the market and protect the investors.
>
> It should, however, be emphasized that an efficient capital market is not an end in itself, as the primary purpose of capital market development is to strengthen the economy and then thereby improve the standard of living of the people. Therefore, efficient capital markets complement and support the productive activities of the economy.
>
> In Pakistan the capital market consists of (i) a dominant non-securities market with well established commercial banks, development finance institutions (DFI), and specialized banks/institutions for industry, agriculture, housing, and small business, as well as a variety of other smaller, younger, and marginally important non-bank financial institutions; and (ii) a rapidly developing securities market, with three organized stock exchanges but which in terms of total funds raised is less significant as compared to the non-securities market.
>
> The non-securities market provides medium and long term equity and debt funds in negotiable form which are issued by corporations and governments or through financial institutions, directly to individual and institutional investors and then traded among different holders.
>
> The securities market for negotiable equity shares and long term debt securities is typically divided into two parts. One is the 'primary' market in which new issues of securities are made by companies and are bought by investors. The other is the 'secondary' market in which the existing securities are traded through financial intermediaries, such as investment banks, brokers, dealers, and individual investors. These institutions quite often provide or arrange for a commitment to the issuing company that the entire new issue will be sold at a set price, thus assuring the company of a fixed amount of total proceeds from the new issue. In addition to liquidity, the secondary market provides a pool of investors to whom new issues may be sold. Thus, while the primary market is necessary to provide issues of securities to be traded in the secondary market, the latter is essential for allowing the new issues to be sold. Thus both markets are mutually re-enforcing.
>
> **Need for Capital Market Development in Pakistan**
>
> So far Pakistan has raised a large portion of its investment funds from national savings, which are routed through national financial institutions such as commercial banks and non-bank financial institutions (NBFIs) as well as through national savings schemes (NSSs). These funds are supplemented by foreign savings in the form of ordinary and concessionary loans from multilateral financial institutions and bilateral agencies as well as commercial loans from foreign banks. A limited but growing amount of total national investment is funded through direct foreign investment.
>
> Furthermore funds are government guaranteed loans from development finance institutions (DFIs) or domestic commercial banks to government indicated/sanctioned projects to private sector and large scale public enterprises. Consequently, most enterprises have an excessive dependence on debt financing and have minimized equity financing. Excessive reliance on debt finance to fund capital intensive projects with low returns has in many cases caused debt servicing problems. Over-reliance on debt has also resulted in unbalanced capital structures, high debt/equity ratios and financial vulnerability to downturns in world and domestic economies.
>
> Government policymakers and planners are aware that over the next decade it will become difficult to (i) fund public development expenditure, especially for public enterprises, through government budgetary allocations because of fiscal constraints; (ii) expect an increase in the flow of foreign commercial loans, because of mounting external debt servicing problems; (iii) rely on increasing supply of external aid funds because of budgetary pressures in developed industrial countries. In the foreseeable future, only foreign investment can fill a portion of the gap left by reduced external flows.
>
> In the light of these structural, financial and attitudinal changes, the achievement of a high rate of growth by Pakistan will significantly depend on the development of domestic capital markets (i) to mobilize increased domestic resources to bridge the projected investment savings gap; and (ii) to efficiently allocate scare capital resources to the most productive investment projects. Moreover, without fully developed equity markets, Pakistan will not be able to increase the availability of equity funding and move towards more balanced capital structures. The development of capital market in Pakistan aside from easing the burden on government funds and mobilizing savings for productive investment would also establish a platform for raising tax revenues in the future.

Role of Commercial Banks in Capital Market

Commercial banks are the dominant financial institutions in the country. They are also playing an important capital market role by providing medium and long term loans for the purpose of financing fixed investment. During 1994-95 the gross disbursement of funds by commercial banks for this purpose amounted to Rs. 9,392 million.

Because of their large asset base, there is still considerable scope for commercial banks to develop medium and long-term funding facilities. In particular, commercial banks could assist the corporate sector by subscribing to convertible commercial bonds paper as well as guaranteeing these for reputable and experienced entrepreneurs. They could also increase their participatory activities with DFIs in consortium financing for projects which have been professionally studied and found to be economically and technically feasible.

Commercial banks' involvement in term lending is, however, a complex issue and its dimensions depend, among other things, on the ability of commercial banks to mobilize medium and long-term resources, as well as on 'term transformation', i.e. the acquisition of long term liabilities on the basis of short term deposits. At present, commercial banks do not have large long term resources and the practice of borrowing short term funds and lending a substantial portion of these on a long term basis carries the risk of liquidity.

Commercial banks also generally do not have adequate institutional expertise for making medium and long term loans on the basis of projects' economic and financial viability and technical feasibility. Moreover, since major commercial banks (except foreign banks) till recently have been government owned, their management tends to be bureaucratic in style, with an emphasis on centralized decision making which discourages management initiative. The commercial banks have also been extensively exposed to political pressures for making loans to projects that do not satisfy the criterion of financial soundness or viability. Unfortunately, commercial banks (and DFIs) have been quite often used for conferring unjustified favours on certain influential individuals.

Source: *The News*, 31 August 1996.

Appendix 14.2

The Role of Capital Markets

Capital markets can play an important role in economic development.

Industrial development is commonly believed to be the engine of economic growth. If that is so, then its fuel must come from the capital markets. Significant economic development is not possible without the sustained availability of long-term funds and long-term funds are really only available through the capital markets. We know that most people save. How much they save and how these savings get re-deployed determines the size and nature of a country's capital markets. The capital markets, therefore, are simply a mechanism for repackaging financial flows. This repackaging can occur in the form of debt or equity. Debt is repackaged as fixed income instruments which offer a guaranteed return to the holder and promise the return of principal at maturity. Equity is a much more fundamental form of investment where the investor shares, to a greater degree, in the fortunes of the issuing company.

It is no coincidence that economies which are more developed than ours also have more sophisticated capital markets. It is also no coincidence that the savings rate in such economies tends to be much higher than the savings rate in Pakistan. Given that our savings rate is pretty poor, are we to conclude that our capital markets are doomed forever? The answer is obviously no, but the daily transactions, the level of the index, etc. have shown tremendous growth since 1989 and credit for this must go to the implementation of sensible, liberal policies. There is also no denying that foreign investment beginning in 1991 activated and propelled the local equity market. This allowed local companies and their sponsors to finally extract embedded values. It also allowed companies to raise money relatively quickly and encouraged issues to realize the benefits of public listing.

That's the good news. The bad news is that the equity market still remains fairly illiquid when compared to other countries in Asia. For instance, Pakistan has approximately 1.5 million investors which compares rather poorly with 25 million in India; and of the 1.5 million less than 5 per cent are really active. The ability of this small number of investors to move the market is therefore significant. In addition, only 20 companies represent approximately 45 per cent of the KSE's market capitalization and only about 15 per cent of issued shares are actively traded. These facts notwithstanding, the trends are positive as more investors are entering the market and large equity holdings are being diluted.

The debt market is a different story. Effectively, the only debt instruments are government bonds and treasury bills and, together with the national saving schemes, they swamp the debt securities market. Until recently, private sector debt securities were severely victimized by discriminatory tax treatment and other disincentives. The net result is that Pakistan's financial backdrop is dominated by commercial lending, either through commercial banks or development finance institutions.

This situation has prevented the development of a private sector debt securities market in which individuals and institutions normally invest. Our system forces most investors to keep their money in bank deposits and other instruments which may yield substantially less than the inflation rate. Given the opportunity, perhaps these investors would rather invest in securities of top quality private sector companies where the yield for 5-year paper could be substantially more rewarding. Until our capital markets allow such instruments to develop, we cannot place any significant reliance on them.

It is inconceivable that Pakistan can achieve its ambitious economic objectives without the growth of its capital markets not only in size but also in depth. When a company cannot raise even US$50 million from its domestic capital markets in local currency, at affordable rates, then we have a problem. Pakistan has begun to access the global capital markets for both equity and debt, but we cannot rely heavily on these markets as they have limited appetite and are driven by profit opportunities in a stable environment that offers liquidity. Although we are moving towards improved stability and liquidity, we are not there yet.

Gloom and doom aside, it is our belief that there is a commitment on the part of all governments, past and present, to support the growth of our capital markets. Recent changes in regulations support this belief. The psyche of our people implies that the equity market will probably remain larger than the debt market for the foreseeable future. New products will be introduced and the investor base is expected to broaden, especially through the additional of mutual funds which will allow smaller investors a greater degree of protection. The equity market should continue to grow given privatization, the inherent growth in companies' earnings and the changed attitude of issuers. With a debt market that is awakening, economic reforms that are irreversible and consistent between governments, exciting developments are expected in the capital markets.

Source: *DAWN*, Advertising Supplement, 28 December 1994.

Appendix 14.3

Keynes on the Stock Market

John Maynard Keynes questions the logic of the stock market and how stocks are priced.

A conventional valuation which is established as the outcome of the mass psychology of a large number of ignorant individuals is liable to change violently as the result of a sudden fluctuation of opinion due to factors which do not really make much difference to the prospective yield; since there will be no strong roots of conviction to hold it steady. In abnormal times in particular, when the hypothesis of an indefinite continuance of the existing state of affairs is less plausible than usual even though there are no express grounds to anticipate a definite change, the market will be subject to waves of optimistic and pessimistic sentiment, which are unreasoning and yet in a sense legitimate where no solid basis exists for a reasonable calculation.

But there is one feature in particular which deserves our attention. It might have been supposed that competition between expert professionals, possessing judgment and knowledge beyond that of the average private investor, would correct the vagaries of the ignorant individual left to himself. It happens, however, that the energies and skill of the professional investor and speculator are mainly occupied otherwise. For most of these persons are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it 'for keeps', but with what the market will value it at, under the influence of mass psychology, three months or a year hence. Moreover, this behaviour is not the outcome of a wrong-headed propensity. It is an inevitable result of an investment market organized along the lines described. For it is not sensible to pay 25 for an investment of which you believe the prospective yield to justify a value of 30, if you also believe that the market will value it at 20 three months hence.

Thus the professional investor is forced to concern himself with the anticipation of impending changes, in the news or in the atmosphere, of the kind by which experience shows that the mass psychology of the market is most influenced. This is the inevitable result of investment markets organized with a view to so called 'liquidity'. Of the maxims of orthodox finance none, surely, is more anti-social than the fetish of liquidity, the doctrine that it is a positive virtue on the part of investment institutions to concentrate their resources upon the holding of 'liquid' securities. It forgets that there is no such thing as liquidity of investment for the community as a whole. The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future. The actual, private object of the most skilled investment to-day is 'to beat the gun', as the Americans so well express it, to outwit the crowd, and to pass the bad, or depreciating, half-crown to the other fellow.

This battle of wits to anticipate the basis of conventional valuation a few months hence, rather than the prospective yield of an investment over a long term of years, does not even require gulls amongst the public to feed the maws of the professional—it can be played by professionals amongst themselves. Nor is it necessary that anyone should keep his simple faith in the conventional basis of valuation having any genuine long-term validity. For it is, so to speak, a game of Snap, of Old Maid, of Musical Chairs—a pastime in which he is victor who says Snap neither too soon nor too late, who passes the Old Maid to his neighbour before the game is over, who secures a chair for himself when the music stops. These games can be played with zest and enjoyment, though all the players know that it is the Old Maid which is circulating, or that when the music stops some of the players will find themselves unseated.

Or, to change the metaphor slightly, professional investment may be likened to those newspaper competitions in which the competitors have to pick out the six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole; so that

each competitor has to pick, not those faces which he himself finds prettiest, but those which he thinks likeliest to catch the fancy of the other competitors, all of whom are looking at the problem from the same point of view. It is not a case of choosing those which, to the best of one's judgement, are really the prettiest, nor even those which average opinion genuinely thinks the prettiest. We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practise the fourth, fifth and higher degrees.

If the reader interjects that there must surely be large profits to be gained from the other players in the long run by a skilled individual who, unperturbed by the prevailing pastime, continues to purchase investments on the best genuine long-term expectations he can frame, he must be answered, first of all, that there are, indeed, such serious-minded individuals and that it makes a vast difference to an investment market whether or not they predominate in their influence over the game-players. But we must also add that there are several factors which jeopardise the predominance of such individuals in modern investment markets. Investment based on genuine long-term expectation is so difficult to-day as to be scarcely practicable. He who attempts it must surely lead much more laborious days and run greater risks than he who tries to guess better than the crowd how the crowd will behave; and, given equal intelligence, he may make more disastrous mistakes. There is no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable. It needs more intelligence to defeat the forces of time and our ignorance of the future than to beat the gun. Moreover, life is not long enough;—human nature desires quick results, there is a peculiar zest in making money quickly, and remoter gains are discounted by the average man at a very high rate. The game of professional investment is intolerably boring and over-exacting to anyone who is entirely exempt from the gambling instinct; whilst he who has it must pay to this propensity the appropriate toll. Furthermore, an investor who proposes to ignore near-term market fluctuations needs greater resources for safety and must not operate on so large a scale, if at all, with borrowed money—a further reason for the higher return from the pastime to a given stock of intelligence and resources. Finally it is the long-term investor, he who most promotes the public interest, who will in practice come in for most criticism, wherever investment funds are managed by committees or boards or banks. For it is in the essence of his behaviour that he should be eccentric, unconventional and rash in the eyes of average opinion. If he is successful, that will only confirm the general belief in his rashness; and if in the short run he is unsuccessful, which is very likely, he will not receive much mercy. Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.

So far we have had chiefly in mind the state of confidence of the speculator or speculative investor himself and may have seemed to be tacitly assuming that, if he himself is satisfied with the prospects, he has unlimited command over money at the market rate of interest. This is, of course, not the case. Thus we must also take account of the other facet of the state of confidence, namely, the confidence of the lending institutions towards those who seek to borrow from them, sometimes described as the state of credit. A collapse in the price of equities, which has had disastrous reactions on the marginal efficiency of capital, may have been due to the weakening either of speculative confidence or of the state of credit. But whereas the weakening of either is enough to cause a collapse, recovery requires the revival of both. For whilst the weakening of credit is sufficient to bring about a collapse, its strengthening, though a necessary condition of recovery, is not a sufficient condition.

These considerations should not lie beyond the purview of the economist. But they must be relegated to their right perspective. If I may be allowed to appropriate the term speculation for the activity of forecasting the psychology of the market, and the term enterprise for the activity of forecasting the prospective yield of assets over their whole life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does, however, increase. In one of the greatest investment markets in the world, namely, New York, the influence of speculation (in the above sense) is enormous. Even outside the field of finance, Americans are apt to be unduly interested in discovering what average opinion believes average opinion to be; and this national weakness finds its nemesis in the stock market. It is rare, one is told, for an American to invest, as many Englishmen still do, 'for income'; and he will not readily purchase an investment except in the hope of capital appreciation. This is only another way of saying that, when he purchases an investment, the American is attaching his hopes, not so much to its prospective yield, as to a favourable change in the conventional basis of valuation, i.e. that he is, in the above sense, a speculator. Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism—which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object.

These tendencies are a scarcely avoidable outcome of our having successfully organized 'liquid' investment markets. It is usually agreed that casinos should, in the public interest, be inaccessible and expensive. And perhaps the same is true of Stock Exchanges. That the sins of the London Stock Exchange are less than those of Wall Street may be due, not so much to differences in national character, as to the fact that to the average Englishman Throgmorton Street is, compared with Wall Street to the average American, inaccessible and very expensive. The jobber's 'turn', the high brokerage charges and the heavy transfer tax payable to the Exchequer, which attend dealings on the London Stock Exchange, sufficiently diminish the liquidity of the market (although the practice

of fortnightly accounts operates the other way) to rule out a large proportion of the transactions characteristic of Wall Street. The introduction of a substantial Government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States.

The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only. But a little consideration of this expedient brings us up against a dilemma, and shows us how the liquidity of investment markets often facilitates, though it sometimes impedes, the course of new investment. For the fact that each individual investor flatters himself that his commitment is 'liquid' (though this cannot be true for all investors collectively) calms his nerves and makes him much more willing to run a risk. If individual purchases of investments were rendered illiquid, this might seriously impede new investment, so long as alternative ways in which to hold his savings are available to the individual. This is the dilemma. So long as it is open to the individual to employ his wealth in hoarding or lending money, the alternative of purchasing actual capital assets cannot be rendered sufficiently attractive (especially to the man who does not manage the capital assets and knows very little about them), except by organizing markets wherein these assets can be easily realised for money.

The only radical cure for the crises of confidence which afflict the economic life of the modern world would be to allow the individual no choice between consuming his income and ordering the production of the specific capital-asset which, even though it be on precarious evidence, impresses him as the most promising investment available to him. It might be that, at times when he was more than usually assailed by doubts concerning the future, he would turn in his perplexity towards more consumption and less new investment. But that would avoid the disastrous, cumulative and far-reaching repercussions of its being open to him, when thus assailed by doubts, to spend his income neither on the one nor on the other.

Those who have emphasized the social dangers of the hoarding of money have, of course, had something similar to the above in mind. But they have overlooked the possibility that the phenomenon can occur without any change, or at least any commensurate change, in the hoarding of money.

Source: Keynes, John Maynard, *The General Theory* (New York: Harbinger Books, 1964), 154-61.

Appendix 14.4

Should Developing Countries Encourage Stock Markets?

Conventional wisdom suggests that all countries must have active equity markets if they are to develop. It is argued that these stock markets will provide scarce capital which can be used for development. However, Professor Ajit Singh questions these assumptions.

Today, however, as a part of a general trend towards liberalization, deregulation, privatization, the diminution of the role of the state and enhancement of that of the market, which for various reasons is sweeping the globe—the North and the South, and what remains of the East as well as the West—an important feature of the development of the financial sector in a large number of developing economies is the very fast growth of stock-markets in these countries. The establishment and expansion of these markets is favoured not just by the Bretton Woods institutions, as one would expect, but also by many heterodox economists as well as those from the centrally planned economies.

The World Bank, particularly through its affiliate the International Finance Corporation (IFC), is actively involved in fostering stock-market development in third world countries and in assisting and encouraging them to open up to foreign portfolio investment. Specifically, the IFC provides technical assistance to a large number of countries on the legal, regulatory, and fiscal issues involved, as well as on other aspects of the institutional framework for the development of these markets. According to Sudweeks, from 1971 to June 1988, 73 countries requested and received capital-market assistance in various forms from the IFC's Capital Markets Department. In 50 of these countries assistance has been provided especially for the development of security markets. Moreover, IFC's pioneering work in establishing the Emerging Markets Data Base (EMDB), which since 1975 has been analysing records of a large number of third world companies and providing basic information on many 'emerging' stock-markets, has been widely acknowledged to be instrumental in stimulating foreign investors' interest in these markets. The IFC in addition has assisted several countries with the launching of the so called 'country funds' to attract foreign portfolio investment to developing-country stock-markets.

The Bretton Woods institutions justify their encouragement of third world stock-markets not on ideological grounds but on the ground that stock-market expansion is partly a natural progression of the development of a country's financial sector as long-term economic growth proceeds. More importantly, it is argued that the existing financial systems, which in many countries have invariably involved government-directed and often subsidized credit to priority industries or firms, have proved to be unsuccessful. The Development Finance Institutes (DFIs) have been the main vehicles for providing long-term finance for industrial development in a number of countries. The DFIs have been facing acute financial difficulties since the economic crisis of the third world began at the end of the

1970s and in the early 1980s. The World Development Report for 1989, which focused on the financial sector, reported that in a sample of 18 industrial DFIs worldwide, on average nearly 50 per cent of their loans (by value) were in arrears, and accumulated arrears were equivalent to 17 per cent of the portfolio value. For three of these institutions, loans accounting for between 70 and 90 per cent of the portfolio values were in arrears. The situation may be worse than the numbers show, because the rescheduling of overdue loans and growing loan portfolios reduce arrears ratios. The Report goes on to observe: The performance of agricultural DFIs has also been poor. Studies show default rates ranging from 30 to 95 per cent for subsidized agricultural credit programmes. In general, the Report argued strongly against the myriad inefficiencies of these DFIs and the bank-based interventionist financial systems; instead, it favoured a restructuring of these systems to make them more 'voluntary', fiscally neutral and to bring them as far as practicable under private ownership. . . .

. . . Essentially, this paper suggests that it is arguable that even in advanced countries with well-functioning markets the stock markets are likely do more harm than good to the real economy. The supposed positive contributions of the stock markets (encouragement of savings, more efficient allocation of investment resources, the discipline of corporate managements through competitive selection in the market for corporate control), . . . do not materialize in practice. The market for corporate control encourages large companies to expand through takeovers, rather than seek organic growth which promotes economic development. Moreover, it is not at all clear that the takeover selection process leads to the survival of firms which are efficient at creating real wealth, rather than being simply skilled in financial engineering.

There is evidence as well as strong analytical grounds for believing that these and related negative features of the stock-markets (speculation, lack of long-term investor commitment to corporations, short-termism) may play a significant role in putting the stock-market dominated economies of the United States and the United Kingdom at a competitive disadvantage in relation to countries such as the Federal Republic of Germany and Japan. These unfavourable aspects of the stock-market are likely to be particularly important in third world countries with undeveloped stock markets and high volatility of share prices.

To the extent that developing countries today have a choice, they should attempt to foster bank-based financial systems more along the lines of the 'follower' countries (Japan, the Federal Republic and France) rather than to establish and encourage stock-markets. Historically, these bank-based systems have a proven record of successfully promoting industrial development in these countries. Moreover, as we have seen earlier, the modern theory of information provides strong theoretical reasons for banks to be on the whole more suitable vehicles for achieving these ends than the stock-market. The ordinary shareholder of a larger corporation has neither the ability nor the incentive to obtain the necessary information (which is costly) to monitor management activities, thus leading him or her to eschew 'commitment' to the organization and to prefer liquidity. The banks, on the other hand, have both the means and the incentive to collect such information and to take a long-term view of firms' prospects—a perspective which is vital for industrialization in developing economies.

Notwithstanding these extremely important advantages of bank-based financial systems, it would be a mistake not to learn from the experience of the last two decades during which, in many developing countries, such systems have performed far from adequately. In a number of developing countries experiencing a high degree of macroeconomic instability bank-based finance has tended to degenerate into inflationary/inefficient finance. Experience suggests the following to be the most serious shortcomings of such systems in the developing-country context:

a) 'crony capitalism', which finances schemes for particular individuals and families with political connections, rather than promoting long-term industrial development;
b) industry-finance links of the bank-based type can in principle, and sometimes in practice, lead to monopolistic positions in product markets and thwart entry by new firms, thereby hindering efficient industrial development;
c) imprudent or inadequate government regulation of banks has sometimes jeopardized the integrity of the financial system as a whole (for example Chile, following financial liberalization in the early 1980s).

Thus, although bank-based systems are much to be preferred in principle to the stock-market-based systems, developing countries should pay particular attention to questions of proper regulation and to the prevention of monopolistic abuse by banks.

However, to be realistic, it must be recognized that stock-markets in developing countries are today a part of the new economic landscape and, notwithstanding their dubious merits in relation to economic development, they are there to stay. The question, therefore, arises how, if at all, can their negative features be contained? The analysis suggests that, from the perspective of economic development, an important general policy principle for the least developed countries should be to attempt to insulate as far as possible the real industrial economy from the influence of the stock market. In this context, the following kinds of policy proposals require careful consideration by developing country governments. First, they should examine schemes of taxation to reduce share turnover as was mooted by Keynes and has more recently been proposed by Tobin in relation to transactions on the international currency markets.

Secondly, the developing countries should be seriously concerned about the effects of a prospective market for corporate control. Since stock markets in these countries are still in their infancy, most of them do not yet have an active market for corporate control (although some takeover bids on the Indian stock markets have been reported in the most recent period). However, as the stock markets become more mature and more firmly established, left to itself the development of a corporate control market is an inevitable evolution . . . such a market greatly accentuates the negative features of a stock market for economic development (e.g. by encouraging short-termism). The developing countries should,

therefore, if at all possible, adopt the German-Japanese type institutional arrangements to pre-empt the development of a market for corporate control of the kind which exists in the Anglo-Saxon countries. However, if that is not feasible, these countries would be wise to take steps to restrict the operations of the market for corporate control. This may involve, for example, major changes in company law, reducing the role of shareholders and enhancing that of the stakeholders or the government in take-over situations.

Thirdly, to the extent that institutional investors, such as pension funds, are public agencies, which appears to be the case in many developing countries, the governments could use them to maintain more orderly markets. Fourthly, and importantly, the governments should encourage product market competition to discipline corporations rather than rely on the stock-market for this purpose. If a developing country possesses or is able to establish a German-Japanese-type financial system, such discipline would be supplemented by bank-monitoring of corporations.

Reducing the negative aspects of the role of the stock-market would require a full exploration of the policy areas outlined above in relation to the specific circumstances of a particular country. Many of these policy issues are currently subjects of considerable debate in the advanced countries. Their application and analysis in relation to developing-country stock-markets requires a separate paper in its own right.

Source: From Singh, Ajit, 'The Stock Market and Economic Development: Should Developing Countries Encourage Stock Markets?', UNCTAD Discussion Paper No. 49 (Geneva: UNCTAD, October 1992), 1, 43–5.

NOTES

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15 Monetary Policy, Savings, and Inflation

Monetary policy is concerned with the regulation of the quantity, cost, and allocation of money and credit in the economy. It is a mechanism that has serious implications for economic development, as it helps determine how and where resources are to be allocated in the different sectors. Monetary policy establishes how much can, and should, be invested and where it should be invested; and by determining the cost of money, monetary policy helps individuals to decide how much they want to save and how much to spend at a particular moment of time. For many economists, inflation is always and everywhere a monetary phenomenon, where excessive monetary growth, beyond the rate commensurate with a particular growth rate of the economy, will result in inflation. Hence, monetary policy, like fiscal policy, is a key determinant of the course an economy can take.

In Pakistan as elsewhere, by definition, fiscal policy has been the purview of the government, which has determined who it is going to tax, how much tax it is going to impose, and how much and where it intends to spend. Monetary policy in many countries has been kept distant from the direct arena of government, and governments have only established the basic rules and eventual targets of monetary policy. The outcome and consequences of these rules and targets are then left to the market to determine. However, in Pakistan, monetary policy has been a much more government-controlled and influenced tool than in many other countries. Interest rates have been predetermined and strict sectoral credit targets defined, and the market has, until recently, not played an influential role. All this has been changing in the last few years, and the government has begun to allow the market to determine some key variables. This chapter will highlight those changes and will show just how much the market now influences monetary policy and where this is all leading to. As we saw in the last chapter, the State Bank of Pakistan was granted considerable autonomy to make decisions which concern it, including determining the rate of interest. However, some critics have argued that despite this autonomy, political pressure and other considerations undermine its role, and decisions are taken giving preference to non-technical factors—see Box 15.1. Appendix 15.1 provides a chronology of reforms in the financial sector since 1990.

Pakistan's savings rate has always been very low and attempts at increasing it have always failed. This chapter will try to examine the reasons why the savings rate is so low and what, if anything, can and should be done to increase that rate. Is inflation always and everywhere a monetary phenomenon? What does the evidence from Pakistan suggest? With double-digit inflation having been the norm for much of the 1990s and again in the period 2008–12, this chapter will assess the possible reasons for high inflation, and examine some of the theories presented by researchers which may help explain why the inflation rate rose.

15.1 Monetary Policy and Monetary Management in Pakistan[1]

Since 1991, the financial sector has undergone a major transformation. Much, in fact almost all, of the pre-1991 measures that constituted monetary policy and the way monetary matters were managed have now been replaced by a different regime of management and policy.

The impetus for the dramatic reforms in the financial sector, like much else in Pakistan in recent years, is provided by the World Bank and the International Monetary Fund (IMF). Just as the Structural Adjustment Programmes (SAPs) since 1988 have dramatically transformed the nature of Pakistan's economy, especially at a macro level, similar reforms under the Financial Sector Adjustment Loan (FSAL) and those under the various Structural Adjustment Programmes have also transformed the nature of Pakistan's financial, fiscal, and monetary sectors. Essentially, there has been a marked transformation in the way monetary policy is conducted, from one that used to be heavily dependent on direct (government) involvement and controls, to one that has now ostensibly become based on indirect (market-based) methods. This has been done, as one observer argues, 'at the urging of the IMF which now is the architect of our economic, fiscal and monetary policies. The IMF has been recommending for some years now a shift to market-based management of monetary policy, as it views management through quantitative methods with distaste; these, in its judgement, result in inefficiency and the misallocation of resources.[2] Before we analyse the nature of these changes, we need to look briefly at the way monetary policy was managed in the pre-1991 period.

Before the 1991 financial sector reforms, the government's debt management programme was considered to be a 'loosely managed, highly unorganized system of on tap and ad hoc treasury bills, and readily refinanced non-marketable long term papers'.[3] In 1972, when the banking sector reforms were undertaken, a National Credit Consultative Council (NCCC) was established to determine the distribution of credit in the economy and to improve and make credit available to those

Box 15.1

How Autonomous is the State Bank in Deciding Monetary Policy?

Muhammad Yaqub provides an analysis of the surprising cut in the discount rate in Pakistan in August 2012, arguing that the State Bank of Pakistan has not shown its independence and has acted under pressure imposed by the government, with an election approaching.

Notwithstanding the de facto surrender to the ministry of finance of its de jure authority to formulate and implement the monetary policy, the State Bank of Pakistan (SBP) goes through the ritual of issuing a statement every two months, pretending that it is in charge of the monetary policy. The ritual has been performed once again and, based on the argument of falling inflation and availability of the Coalition Support Funds (CSF), the SBP came up with an alibi to announce the lowering of the policy rate by 150 basis points to 10.5 per cent on 10 August.

It made no economic sense to reduce the policy rate in an overheated economy because of a temporary relief to the budget provided by the windfall of the CSF or a likely-to-reverse one-month relapse in inflation as recorded in the official consumer price index. Had the government made a bold effort to raise tax revenue and contain expenditure in order to bring the structural budget deficit under control, there could be an expectation of a reduction in government borrowing from the banking system on a durable basis. In that context, a lowering of the policy rate to help the private sector would have made sense.

The information compendium shows that the economy has been flooded with money supply generated by excessive government bank borrowing in the last several years. In FY12 alone, public-sector deficit (recorded properly) comes close to about 10 per cent of the GDP and the bulk of it was financed by borrowing from the SBP and the commercial banks. It added immensely to the already existing overhang of liquidity whose impact will continue to be reflected in higher domestic prices, rise in imports, stagnation in exports, depletion of foreign exchange reserves, and depreciation of the exchange rate.

What was required under the prevailing situation was an effort on the part of the SBP to work off the overhang of liquidity. As the liquidity was being generated by excessive government bank borrowing, the obvious policy conclusion is that the SBP should use its professional analysis and statutory authority vested in it by the SBP Act to persuade/compel the government to limit its borrowing from the banking system. Without closing the flood gate of government bank borrowing, the SBP has lower the policy rate reducing the government's cost of borrowing from the commercial banks and providing an incentive for expansion in credit to the private sector. The consequence will be acceleration in the rate of growth in the net domestic assets of the banking system and addition to excess demand in the economy.

Going through the policy statement one gets a contradictory and somewhat confusing message. The SBP analysis of the underlying economic and financial situation is professional and valid, but its policy decision with respect to the monetary policy is contrary to the analysis and wrong. There is thus an obvious break in the link between the professional analysis and the policy decision of the SBP. The only conclusion that one can draw from this paradox is that the analysis is done professionally but the decisions are made or dictated politically.

The contradiction between the analysis and the policy conclusion confirms that the decision about its policy rate was not made at the SBP, or at least at its professional level.

If the central bank of the country becomes a willing partner to inflation on political or expediency considerations, feels comfortable with double-digit inflation over a period of four years, is indifferent towards the high rate of increase in money supply over a long period, and then reinforces these trends by lowering the policy rate on a flimsy basis, the only thing one can do is pray to God to have rainfall of dollars over the country to save it from economic disaster. Otherwise, the domestic excess demand will inevitably find its way into the balance of payments and bring about a foreign exchange crisis faster than previously anticipated.

The decision to lower the policy rate will be hailed by the business community because it serves its vested interests and will be played up by the government to gain political mileage out of it. However, it will hurt further the majority of the people and the economy through rising prices and will have no favourable impact on long-term investment, employment, and growth which depend on a host of complex factors other than the policy rate. More importantly it sadly proves that the SBP is not in charge of its monetary policy or its current management does not understand its role and responsibilities.

For several years, the monetary outcome is basically being driven by the financing requirements of the public sector and interest rates on government bank borrowing are decided on political and fiscal policy considerations in Islamabad, rather than on monetary policy considerations in Karachi. Thus, the expectation that, once statutorily autonomous, the SBP would effectively take charge of the country's monetary policy has unfortunately not materialised. More importantly, by limiting the scope of the monetary policy to the announcement of the policy rate determined arbitrarily, the SBP has trivialized the role of the monetary policy in macroeconomic management and undermined the professional standing and statutory authority of the SBP as the central bank of the country.

During 1994–97, legislation was passed to give autonomy to the SBP to regulate the banking system and to formulate and execute an independent monetary policy on professional basis without government interference. It was expected that the legislative reforms will enable the SBP to become de facto a truly independent central bank that was to ensure, inter alia, adequate flow of credit to the private sector at reasonable interest rates, with the scope of government borrowing from the banking system determined residually by the SBP on sound monetary policy considerations rather than arbitrarily by the ministry of finance, under fiscal policy compulsions or because of the lobbying power of vested-interest groups.

Faithful adherence to the legislation would have ensured a central role of the SBP in the formulation and implementation of the monetary policy, including determination of the safe

limits of public-sector bank borrowing, adequate availability of credit to the private sector and an appropriate control on money growth consistent with the inflation target. It also would have compelled the government to put its fiscal house in order through tax reforms and expenditure control. But it was not to be.

The laws have not been followed in practice either by the government nor the SBP in the matter of the monetary policy—even if those remain on the books, and, ironically, were even strengthened further by the present government to meet IMF conditionality. But laws are as good as their implementation and the focus of all the parties, including the IMF, should shift from proposing further amendments in banking laws to effective enforcement of the existing ones.

The political leadership should realise that the shortcuts that come to their minds to address the difficult economic problems are usually the wrong cuts. If pump priming of an underdeveloped economy through large-scale note printing and/or heavy rainfall of bank credit were a solution of structural unemployment and poverty, by now no country would have those problems.

The manipulation of the banking system and of the monetary policy for political ends is not the answer to the deep-rooted structural economic problems. There is a need for the politicians to pause and ponder and launch a sound programme of structural economic reforms to take the country out of its economic quagmire. At the same time, the SBP should measure up to its de jure responsibilities and use its professional expertise and legal authority to carry with it whichever government is in power to let the monetary policy and the banking system function on sound professional footing to promote larger national interests.

Source: Yaqub, Muhammad, 'Misusing the Monetary Policy', *The News*, Karachi, 12 August 2012.

Box 15.2

The Annual Credit Plan and Monetary Policy

Aftab Ahmad Khan explains how monetary expansion is determined each year.

In Pakistan the framework of regulatory monetary policy is provided by the Annual Credit Plan which is recommended by the National Credit Consultative Council (NCCC), a body set up under the aegis of the State Bank of Pakistan with the following functions: (i) to review the overall credit situation in the country with specific reference to its region-wise and sector-wise distribution and concentration; (ii) to make recommendations to the government with regard to monetary and credit expansion within safe limits and distribution of credit among various sectors and regions in conformity with the socioeconomic objectives and priorities and targets set out in the Annual Plan; (iii) to set out specific targets for (a) agricultural loans, and (b) small loans to be provided by commercial banks; and (iv) to periodically review the progress made in the implementation of its recommendations and, if necessary, modify or amend its previous recommendations in the light of the emerging situation.

In determining the safe limits of monetary expansion during a particular year, NCCC takes into account: (i) projected growth rate of Gross Domestic Product (GDP) for the year; (ii) the estimated rate of monetization of the economy; (iii) likely changes in the demand for cash balances; (iv) likely changes in prices including those originating in the external sector; and (v) expected changes in net foreign assets. The State Bank, after the legislation passed in February 1994, has been endowed with exclusive powers to regulate the monetary and banking system. It now provides quantitative guidelines about the safe limits of government borrowing and promptly advises the government when these limits are exceeded. It also reminds the provincial governments to stay within the limits of their ways and means advances. Notwithstanding these additional powers, the State Bank cannot pursue a sound monetary policy without the exercise of fiscal responsibility by the Government. Fiscal operations of the government are a dominant factor in determining the monetary outcome in the country. It is not only through borrowing from the banking system for budgetary support that government impacts on money supply but also indirectly through the utilization of privatization proceeds, short term borrowings from abroad and credit creation for specialized schemes. Pakistan's experience indicates that large fiscal deficits lead to excessive monetary expansion and often result in crowding out the private sector. In such situations the room for manoeuvre for the central bank tends to be restricted to attempting to offset its inflationary impact by limiting the secondary expansion of credit. Fiscal and monetary policies have not only to be appropriate but mutually supportive.

Source: Khan, Aftab Ahmad, 'Recent Monetary Trends and Revised Credit Plan', *The News*, Business and Finance Review, 16 March 1996.

areas that had, prior to the nationalization of banks, not been given appropriate amounts of credit. The NCCC became the government's main, if not the only, source of managing monetary policy. An Annual Credit Plan was—see Box 15.2—devised each year, according to which the government would determine the extent of monetary expansion for the year, and allocated credit to the various sectors of the economy. All rates of return were administered by the government and all

institutions and players in the money market and in the rest of the economy had to accept the given rates and amounts of monetary expansion and credit.

A captive market for Treasury Bills existed on 'tap' (on demand) and these bills were issued on an ad hoc basis as and when the government required. Commercial banks, most of which were nationalized and government owned—hence the 'captive' market—were required to use their liquidity to buy these bills at fixed rates of return. Unlike in the period after 1991, the bills were redeemable at any time, making this aspect of the money market 'inflexible and unstructured'.[4] Moreover, the government utilized the National Savings Schemes to raise its debt from instruments that had high rates of return, causing funds to be moved out of the financial sector to these savings schemes.

The main mechanisms of monetary policy and management between 1972 and 1991 were the control of the volume, cost, and allocation of credit

> through the techniques of credit budgeting and credit ceilings rather than having recourse to traditional indirect methods of control, like changes in the bank rate and open market operations. Aside from global and sectoral credit ceilings, the instruments used by this policy of directed credit control included budget subsidies, credit floors, refinancing facilities, together with the imposition of cash reserves and liquidity requirements.[5]

The fiscal requirements of the government, as elaborated in the budget each year, used to determine how the government would manage its credit and debt policy for the year. The government used to borrow from the State Bank of Pakistan by selling its ad hoc (on tap) Treasury Bills at a rate of return of 0.5 per cent per annum. Commercial banks 'had to invest at least 30 per cent of their demand and time deposits in GOP [Government of Pakistan] paper. The paper that they invested in was also available "on tap" and carried a low rate of return of 6 per cent per annum.'[6]

If the role and objective of monetary policy is to maintain a relatively stable economic environment such that investment and growth take place at a regular pace, and there is price stability, it would be fair to say that the dirigiste policies prior to 1991 worked fairly well. The government had pursued an economic growth strategy by controlling interest rates, directing credit to priority sectors, and obtaining cheap credit from the banking sector for budgetary support. The growth rate in GDP averaged 4.8 per cent annually during the 1970s, rising to 6.5 per cent across the 1980s. The inflation rate was more than 12 per cent on average in the 1970s, but was due not to monetary mismanagement or excessive monetary expansion, but largely to factors not in the control of the government, such as the quadrupling of the oil price and numerous crop failures (see Chapter 7 on the Bhutto period). During the 1980s, the inflation rate—despite very high budget deficits, often in excess of 8 per cent of GDP—remained quite low, at an annual average of only 7.3 per cent. Nevertheless, conventional wisdom in the 1990s went out of its way to deride almost all the policies prior to the reforms, and the financial sector and monetary policy were no exception (see Chapters 16 and 17).

Ashfaque Hasan Khan, in particular, has been one of the harshest critics of government financial and monetary policy as it existed prior to the financial sector reforms. He has also been one of the more vociferous proponents of market-based reform of the financial sector.[7] About the structure of the financial sector and the way it functioned between 1972 and 1991, he writes:

> Prior to undertaking financial sector reforms the hallmark of Pakistan's financial sector has been the direct controls on interest rate movements, domestic credit controls (bank specific credit ceilings and selective credit allocations), high reserve requirements, segmented financial markets, the absence of well-developed securities markets, underdeveloped banking system, and commercial banks serving as captive institutions. In particular, the policies of imposing ceilings on interest rates accompanied by directed and rational allocation of credit to 'priority' sectors at low rates have led to widespread 'financial repression' in Pakistan. These policies are seen to impede financial 'deepening' which, in turn, weakens an important set of impulses to faster economic growth.[8]

Ashfaque Khan[9] and Javed Mahmood identify the following adverse effects of the policies that were adopted.

1. There was an excess liquidity problem as banks, while accepting as many deposits as came their way, were not able to lend them due to the credit ceilings imposed on them. Of the amount that banks lent, a large proportion went in the form of directed credit to subsidized sectors at unprofitable, low rates. Thirty per cent of the deposit base of banks was to be invested in low-yielding government debt as part of the liquidity ratio and a minimum of 5 per cent was to be kept in the form of a cash reserve requirement, which earned no interest. 'Given these 'captive' sources of funds, the government could repress the interest rates payable on its borrowing from the commercial banks. Thus, the combination of credit ceilings and low return on government debt reduced the returns on asset portfolios. Furthermore, after meeting the credit ceilings a certain proportion of funds remained unutilized and were not earning any return which led to the emergence of an excess liquidity problem. Consequently the banks were discouraged to mobilize domestic savings through their vast network of branches.'[10]
2. Non-performing loans on political and uneconomic grounds affected the profitability of commercial (mainly nationalized) banks as they could not offer a high rate of return on deposits, hence discouraging these deposits (see Chapter 14).
3. Non-bank financial institutions (NBFIs), which were not under the supervision of the SBP, were able to mobilize a larger amount of financial savings than banks and were also able to override the credit ceilings, thus undermining the SBP's targets and plans.

4. Since interest rates on government savings instruments were higher than those offered by commercial banks, the 'segmentation' of the financial market took place. This disparity also created an anomaly in the interest rate structure.
5. A disintermediation of the financial sector took place due to 4-above, as investors and savers shifted from banks to the higher-interest National Savings Schemes.
6. The government of Pakistan's debt structure was of a short-term maturity, requiring regular outflows and heavy refunding (see Chapter 10).
7. As a result of the above structure, the government did not have much control over the issuance of debt, since new issues were mainly demand driven. Moreover, since the Treasury Bills were redeemable at any time, the debt management programme became inflexible and unstructured.
8. 'There was a lack of cash management control deriving from the encashments feature on government of Pakistan debt. This led to an unpredictable and volatile pattern of encashment which complicated cash forecasting and reduced the government's ability to manage this cash balances.'[11]

It was this old structure with its numerous problems and consequences that came under attack by the IMF and the World Bank. These two organizations suggested a drastic restructuring and reorientation of the financial system, to replace it with a more market-oriented structure. The reforms were to:

> (i) remove distortions and segmentation of the financial markets by creating a homogeneous market for government debt instruments in which all individuals and institutions can participate; (ii) switch from an administered interest rate setting to market based interest rate determination by indicating a regular auction programme of government debt; (iii) allocate credit in response to market forces by gradually eliminating the directed credit schemes and abolishing the subsidized credit schemes; (iv) create and encourage the development of secondary market for government securities—absolutely essential for the success for the auction programme of government debt; (v) strengthen the health and competitiveness of the banking system by recapitalizing and restructuring the nationalized commercial banks, increasing their autonomy and accountability and allowing private banks to enter the market; and (vi) improve prudential regulations and supervision of all financial institutions.[12]

One of the earlier measures taken as part of the reforms was the discontinuation of the system of credit ceilings after 1 July 1992. Bank credit was then regulated by changes in the bank rate and the liquidity ratio, by setting a credit–deposit ratio (CDR)—see below—by setting maximum and minimum lending rates, and most importantly, by a system of open market operations.

One of the principal aims of the government on the advice of the IMF and World Bank has been to establish a market-determined money market, where instruments in primary and secondary markets are traded to regulate money, credit, and the interest rate (see Box 15.3). The government started the auctioning of Treasury Bills in April 1988, but the amounts were very small and commercial banks with excess liquidity were ready buyers of the bills. The programme did not really have much of an impact on any of the important variables in the money market. With a very low rate of return on Treasury Bills not reflecting the market rate, and a higher return on National Savings Scheme instruments, it is not surprising that there were no takers of the Treasury Bills.

In 1991, the government started a full-fledged system of auctioning of government debt and allowed the rate of return on Treasury Bills to rise from the unrealistic 6 per cent where it was fixed earlier, to a more realistic 13 per cent. Other, long-term instruments in the shape of Federal Investment Bonds (FIBs) with a maturity of three, five, and ten years were introduced (see Box 15.4). With the removal of the credit ceilings and with higher rates of return, banks became interested in these instruments. They also began to encourage deposits as their ability to lend and invest was now dependent on the amount of deposits they were able to generate. Appendix 15.2 describes the main features of the money market in Pakistan.

From the initial attempts of auctioning Treasury Bills in 1991 onwards, the State Bank of Pakistan now feels that the auctioning of Treasury Bills is fully integrated with open market operations. From January 1995, according to the State Bank 'open market operations became the major instrument of market based monetary management in the context of a liberal CDR'.[13] Instead of regulating the volume of money through the allocation of credit and the manipulation and limitation on how much banks should lend, the State

Box 15.3

The Primary and Secondary Markets

The financial sector is composed of the money market and capital markets, with primary and secondary dealers.

The *primary market* consists of investment banks, brokers, dealers, the State Bank of Pakistan, commercial banks, and individual investors who conduct sales of new issues. The *secondary market* has brokers, dealers, and banks which buy the securities and then sell them to investors. The *secondary market* is meant to provide liquidity and a pool of investors to whom new issues are re-sold.

Both markets are mutually reinforcing, as the primary market is necessary to provide new issues of securities, and the secondary market is essential for issues to be sold and to provide liquidity to the holders of the securities.

Box 15.4

Money Market Instruments

The following extract describes the nature of two money market instruments: Treasury Bills and Federal Investment Bonds.

Treasury Bills

More familiarly known as T-Bills, these are negotiable, non-interest bearing securities, with an original maturity of one year or less. In Pakistan, presently, the maturity is six months. They are issued by the SBP with a face value of Rs. 100 and in minimum denominations of Rs. 1000 with multiples thereafter. SBP now also can hold the bills in Book Entry Form known as the Subsidiary General Ledger Account (SGLA).

The SBP invites bids for the sale of treasury bills every fortnight. Bidders are required to indicate a price at which they will buy the bills along with the quantity wanted. The auction is open to individuals, institutions, and corporations including banks and DFIs and the bids must be made to the SBP through one of the primary dealers. Successful bidders are required to deposit the requisite amount, for the settlement of the accepted tender, through their primary dealers. Scheduled commercial banks are allowed to invest in treasury bills and these may be counted towards their liquid asset requirements. T-Bills can be held in the form of stock certificates, or as uncertificated bonds at the SBP. Technically, T-Bills can also be traded on the stock exchange. T-Bills are always issued at a discount from face value, and the amount of the discounts is determined in T-Bills auctions held by the SBP each time it issues new bills. At maturity, bills are redeemed by SBP for full face value. The investors thus earn a return because they receive more for the bills at maturity than they paid for them at issue. This return is treated as ordinary interest income and is taxable.

Federal Investment Bonds (discontinued in June 1998 and replaced by Pakistan Investment Bonds PIBs)

These bonds are negotiable long term Government of Pakistan debt instruments of 3, 5, and 10 year maturities. The purpose of their introduction was three-fold. Firstly, it was to provide an outlet for provident funds which were not allowed to invest in Defence Savings Scheme and National Savings Certificates. Secondly, it would establish a yield curve for Government of Pakistan debt which would reflect market risks, and, thirdly, it would provide the Government of Pakistan with a sizeable stock of permanent debt. FIBs pay 13, 14, and 15 per cent p.a. on bills maturing in 3, 5 and 10 years, respectively. Since returns on FIBs are taxable, this sort of rate structure reduces the net debt servicing burden to the Government of Pakistan without sharply reducing the posted rate of return. The rate structure also allows provident funds to be invested in securities with returns similar to those from NSS [National Saving Schemes] and DSC [Defence Saving Certificates], as well as establishes a positively sloped yield curve which should encourage the term extension of debt. FIBs are auctioned every two months. These bills are issued at a face value of Rs. 100 and in multiples of Rs. 1000. As in the case of T-Bills, investors are required to quote a price at which they will be willing to buy the bonds. Separate bids are made for the purchase of bonds of different maturities and prices. (Upon the introduction of FIBs, SBP did not accept tenders at a discount. The banks, especially the NCBs, were quite willing to accept a cut in their rates of return since FIBs presented an excellent opportunity through which they could mop up their excess liquidity. Shortly after, SBP imposed a maximum limit upon holdings of FIBs regarding the NCBs. This resulted in subsequent bids being placed at a discount or at par). Profit on FIBs is paid bi-annually from the date of issue, and a withholding tax is levied on any profits which might accrue from such an investment. Nevertheless, profits earned on investment in FIBs by charitable trusts are exempt from payment of income tax. FIBs can also be traded on the stock exchange.

Source: Mahmood, Javed, 'Money Markets in Pakistan: Concepts, Instruments and Operations', *Journal of the Institute of Bankers in Pakistan*, vol. 58, no. 1, 1992, 39–42.

Bank has gradually moved towards an increasing use of the market mechanism. The direction is one in which open market buying and selling of government securities, along with the determination of the interest rate, becomes the main instrument of monetary policy. Henceforth, the federal government is supposed to raise funds at the market rates of return through the auctioning of government securities. See Appendix 15.3 for a good account of the changes implemented.

Another important measure taken under the aegis of the reforms was the removal of the maximum lending rate which banks used to charge their clients. Before 1995, the maximum lending rate that had been imposed by the State Bank of Pakistan, ranged from 17.5 to 22 per cent between 1993 and 1995. The State Bank decided not to impose any limit and removed the cap entirely in March 1995. This step was considered to be an important move towards making monetary and credit policy more market oriented as commercial banks can now charge any rate they want and their clients agree to. The State Bank, however, still controls the lending rate for concessionary finance for exports, the sale and purchase of locally manufactured machinery, and agricultural loans to small farmers. In all other areas, each bank can charge its own lending rate. The rationale for this move on the part of the State Bank, as it has been with almost all steps since 1992, is to allow the rate of return to be determined by the supply and demand of loanable funds. However, see the very interesting excerpt from the paper by Joseph Sliglitz and Andrew Weiss, on credit and the law of supply and demand (Box 15.5) and (Box 15.6).

Box 15.5

Credit and the Law of Supply and Demand

With the growing desire to let the market determine the price for credit, i.e. the interest rate, it is believed that the forces of supply and demand would allocate credit at an appropriate price. However, a pathbreaking article by Joseph Sliglitz and Andrew Weiss argues that, despite excess supply or demand for credit, the interest rate will not automatically fall/rise to clear the market, and credit may in fact be rationed.

Why is credit rationed? Perhaps the most basic tenet of economics is that market equilibrium entails supply equalling demand; that if demand should exceed supply, prices will rise, decreasing demand and/or increasing supply until demand and supply are equated at the new equilibrium price. So if prices do their job, rationing should not exist. However, credit rationing and unemployment do in fact. They seem to imply an excess demand for loanable funds or an excess supply of workers.

One method of 'explaining' these conditions associates them with short- or long-term disequilibrium. In the short term they are viewed as *temporary disequilibrium* phenomena; that is, the economy has incurred an exogenous shock, and for reasons not fully explained, there is some stickiness in the prices of labour or capital (wages and interest rates) so that there is a transitional period during which rationing of jobs or credit occurs. On the other hand, long-term unemployment (above some 'natural rate') or credit rationing is explained by governmental constraints such as usury laws or minimum wage legislation.

In *equilibrium* a loan market may be characterized by credit rationing. Banks making loans are concerned about the interest rate they receive on the loan, and the riskiness of the loan. However, the interest rate a bank charges may itself affect the riskiness of the pool of loans by either: 1) sorting potential borrowers (the adverse selection effect); or 2) affecting the actions of borrowers (the incentive effect). Both effects derive directly from the residual imperfect information which is present in loan markets after banks have evaluated loan applications. When the price (interest rate) affects the nature of the transaction, it may not also clear the market.

The adverse selection aspect of interest rates is a consequence of different borrowers having different probabilities of repaying their loan. The expected return to the bank obviously depends on the probability of repayment, so the bank would like to be able to identify borrowers who are more likely to repay. It is difficult to identify 'good borrowers', and to do so requires the bank to use a variety of *screening devices*. The interest rate which an individual is willing to pay may act as one such screening device: those who are willing to pay high interest rates may, on average, be worse risks; they are willing to borrow at high interest rates because they perceive their probability of repaying the loan to be low. As the interest rate rises, the average 'riskiness' of those who borrow increases, possibly lowering the bank's profits.

Similarly, as the interest rate and other terms of the contract change, the behavior of the borrower is likely to change. For instance, raising the interest rate decreases the return on projects which succeed. We show that higher interest rates induce firms to undertake projects with lower probabilities of success but higher payoffs when successful.

In a world with perfect and costless information, the bank would stipulate precisely all the actions which the borrower could undertake (which might affect the return to the loan). However, the bank is not able to directly control all the actions of the borrower; therefore, it will formulate the terms of the loan contract in a manner designed to induce the borrower to take actions which are in the interest of the bank, as well as to attract low-risk borrowers.

For both these reasons, the expected return by the bank may increase less rapidly than the interest rate; and, beyond a point, may actually decrease.

But the interest rate is not the only term of the contract which is important. The amount of the loan, and the amount of collateral or equity the bank demands of loan applicants, will also affect both the behaviour of borrowers and the distribution of borrowers. We show that increasing the collateral requirements of lenders (beyond some point) may decrease the returns to the bank, by either decreasing the average degree of risk aversion of the pool of borrowers; or in a multi-period model inducing individual investors to undertake riskier projects.

Consequently, it may not be profitable to raise the interest rate or collateral requirements when a bank has an excess demand for credit; instead, banks deny loans to borrowers who are observationally indistinguishable from those who receive loans.

It is not our argument that credit rationing will always characterize capital markets, but rather that it may occur under not implausible assumptions concerning borrower and lender behaviour. . . .

We reserve the term credit rationing for circumstances in which either (a) among loan applicants who appear to be identical some receive a loan and others do not, and the rejected applications would not receive a loan even if they offered to pay a higher interest rate; or (b) there are identifiable groups of individuals in the population who, with a given supply of credit, are unable to obtain loans at any interest rate, even though with a larger supply of credit, they would.

The law of supply and demand is not in fact a law, nor should it be viewed as an assumption needed for competitive analysis. It is rather a result generated by the underlying assumptions that prices have neither sorting nor incentive effects. The usual result of economic theorizing: that prices clear markets, is model specific and is not a general property of markets—unemployment and credit rationing are not phantasms.

Source: Sliglitz, J. E. and Andrew Weiss, 'Credit Rationing in Markets with Imperfect Information', *American Economic Review*, June 1981.

Box 15.6

Financial Liberalization and Some Possible Consequences

The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) has criticized the imposition of Structural Adjustment Programmes in the region.

> Increased reliance on the market mechanism has not led to a complete resolution of market failures in the developing countries, their zeal for financial sector reforms notwithstanding, remarks the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) in its recent report.
>
> Such zeal might land them in greater macroeconomic instability particularly through the opening up of capital markets, UNESCAP has warned, while characterizing these as the 'new battlegrounds for savings' where market players 'will become a new class of stateless legislators' and with the power of the purse, they will check governments' ability to tax, spend, borrow or depreciate their debts through inflation.
>
> The degree to which the financial sector in a country actually performs its functions is directly related to its level of development. Giving an example of market failure, the report points out that banking industry in the Third World is generally characterized by oligopolistic structure. Thus, for example, the share of the four largest banks in the total assets of the banking system was as high as 60 to 65% in 1987 in Indonesia, Malaysia, Taiwan, and Thailand.
>
> While discussing motivations behind designed and directed credit programmes, controlled interests rates, etc. the UN agency recalls that the existing or emerging banking and financial institutions in the private sector catered mostly for the needs of the urban sector, whereas most of economies of the region were traditionally rural-agricultural with small urban sectors. (In Pakistan, a big foreign bank with newly established branches in Pakistan persistently refuses to accept agricultural assets as collateral and encourages opening of foreign currency accounts by offering credit at the concessional rate of 14%!) Hence, the establishment of specialized financial institutions and, in some cases, the nationalization of commercial banks.
>
> As the financial sector is closely interrelated with the real economy of a country (and with the conduct of its monetary and fiscal policies), the report has stressed, 'its reform should ultimately have a positive impact on the real economy influencing, inter alia, the growth and structure of production and of trade'.
>
> The mobilization and allocation of savings through the financial systems are intermediate processes: Their role is ideally to keep the costs of borrowing financial resources low while encouraging, or at least not discouraging, savings.
>
> It is contended that this balancing act is best performed through a competitive market mechanism. However, the report argues, this mechanism 'has limitations' as market failures are not unusual in the finance area.
>
> Apart from this, it adds, 'some new concerns have arisen connected with increased inherent instability, more demanding forms of transparency, accountability, and supervision and a more indirect and difficult conduct of monetary and exchange rate policies'.
>
> Citing 'contradictory experiences' of Japan, South Korea, China, as well as South Asian countries, it wonders whether financial liberalization 'is either a necessary or sufficient condition for successful economic growth and development'. Rather the experiences of the countries that have undertaken financial reforms show that a stable macroeconomic environment is an essential condition for the reforms to function, as 'reforms carried out against an unstable macroeconomic background can make that instability worse'.
>
> A liberalized system may lead to a socially unacceptable distribution of credit. Disadvantaged groups may not have access to credits through regular channels for the following reasons: (a) remote physical location; (b) rules on collateral which they cannot meet; (c) the small amount of credit they apply for being inefficient for banks to handle; or (d) Interest rates beyond their means.
>
> These constraints have direct implications for the achievement of social goals and for income distribution, UNESCAP points out.
>
> One consequence of a more market-based system is an increased exposure to various forms of instability. For example, the new easier entry for financial institutions, including banks, provided for in the liberalization process can lead to a proliferation of financial institutions. They may accumulate unbalanced portfolios of assets and liabilities, an unsustainable set of non-performing loans and so may collapse—as in the Philippines.
>
> Then there is the instability generated through the capital markets. These markets are, however, well-known for booms and busts largely unrelated to market fundamentals. Such movements are often caused by speculative runs and recently have tended to be exaggerated by the activities of investment funds which make decisions based on computer programme signals.
>
> In Thailand, for example, the sharp decline in December 1994 was imputed to have been started by sales by foreign institutional investors but exaggerated by sales by local funds.
>
> UNESCAP has, in this context, drawn the member countries' attention to two issues of very grave nature:
>
> **(a)** Increasing recourse to currency substitution, whereby the debts and savings in local currency in some developing countries are being replaced by debts and savings in foreign currency. This reduces the control of a Government on its own money supply and the effectiveness of any changes it tries to induce; and
>
> **(b)** How much of the expanded activity on stock markets actually relates to new physical investment, rather than a churning of funds or a refinancing of existing debts.
>
> 'While this may be a temporary phenomenon as enterprises and investors adapt to their new freedom and expanded menu of opportunities, it does call into question the impact of financial reforms on the performance of the real economy and the need to encourage direct foreign investment when possible,' the report remarks.
>
> In the process of globalization of financial sectors, it further observes that the degrees of freedom of smaller countries to make independent policy decisions are becoming severely restricted as both domestic and foreign concerns will react quickly to the signals given. Moreover, it adds, changing circumstances or policies of the major economies can create large reactions in small economies irrespective of their own policies and position.

Source: *DAWN*, 21 May 1995.

As has been shown above, the system of credit ceilings was discontinued after July 1992 and replaced by a credit–deposit ratio (CDR), a ratio that the government has changed and liberalized over time. While the government claimed that this was an important step towards indirect methods, Ashfaque Khan argues correctly that 'qualitatively, a shift from credit ceilings to CDR does not make any difference, with the exception that the extension of credit is now linked with the deposit mobilization efforts of the commercial banks'.[13] The CDR was not applicable to a number of sectors related to the government's directed credit programme, and moreover, it applied only to commercial banks and not to NBFIs. Ashfaque Khan considered the shift from credit ceilings to CDR to be 'not in the spirit of financial liberalization, and therefore, needs to be gradually phased out'.[14] The credit deposit ratio was subsequently abolished on 30 September 1995.

The abolition of the CDR was another important step on the road towards a fully market-based structure of credit availability in the economy. According to one analyst, by taking this measure, the 'State Bank of Pakistan has made a decisive beginning towards lessening its dependence on quantitative credit controls and placing reliance on market based instruments of monetary policy. [The] abolishment . . . will release an additional large bulk of amount for lending to the private sector . . .'.[15] Instead of regulating the volume of money through, amongst other mechanisms, the CDR, the State Bank now makes more use of the market mechanism. As far as commercial banks are concerned, they will (at least technically) be allowed to invest their entire portfolio after allowing for the liquidity ratio and other reserve requirements imposed by the State Bank. This measure should inject a large amount of credit into the market, possibly (if the market is allowed to function) having a downward impact on the interest rate structure. While a lower rate of interest may have positive impacts on loans and investment, it may also result in an excessive expansion of credit, possibly affecting inflation. One of the most noticeable impacts of this policy has, indeed, been the substantial lowering of interest rates in Pakistan, which, in 2003, were at historic lows. With financial sector liberalization and deepening and with such low interest rates, consumer financing prospered immensely. However, towards the end of the 2000s, the rate of interest started to rise again, and touched around 16 per cent.

A large number of reforms have taken place in the financial sector since 1992, as Appendix 15.1 shows, and include the opening up of the banking sector to the private sector; the decontrol of interest rates from government intervention; much greater reliance on market forces to determine monetary policy; an improvement in the quality of financial intermediation and an expansion of the financial sector; and an increase in financial institutions. The reforms have helped banks to increase their profits, and a great deal of financial deepening has also taken place. Nevertheless, there are at least two areas where expected reforms have not taken place. Interest rates, for all practical purposes, are still controlled by the government—see Box 15.1—and a secondary market, supposedly a key factor in a well-functioning, market-oriented money market, has not developed fully.

Although the auctioning system for Treasury Bills and Federal Investment Bonds (FIBs)—the auctioning of FIBs was discontinued in 1998 and were replaced by Pakistan Investment Bonds (PIBs)—has come a long way since its inception in 1988 and a primary market for government debt has developed, the lack of a well-functioning secondary market has been a cause for concern. Since Treasury Bills and FIBs are non-redeemable before maturity, the secondary market should provide a market-based avenue of liquidity for holders of these government securities. Moreover, 'if the period between the subsequent primary auctions is long enough, the secondary market also provides a channel through which the buyers can have access to securities at all times. In other words, the secondary market enables investors to exchange securities for cash at any time they wish.'[17]

Ashfaque Khan[18] and Aftab Ahmad Khan[19] identify a number of reasons why the secondary market has not developed:

1. A lack of trust between financial institutions and the Ministry of Finance. The Ministry of Finance (MOF), acting on behalf of the State Bank, 'is perceived to be fixing prices of securities in an arbitrary fashion in order to keep debt servicing costs low, thereby hindering the functioning of the markets, whereby the MOF suspects that Primary Dealers are colluding and 'fixing' the interest rates'.[20]
2. The government has taken arbitrary and inconsistent actions in accepting and rejecting bids, and it is believed that fiscal considerations, rather than monetary policy, have been determining the debt management strategy.
3. There are a few very large and a number of small players in the secondary market, who trade in a limited number of securities.
4. Other government paper, which is vastly superior to Treasury Bills and FIBs, in terms of rate of return and tax exemptions, has reduced the attractiveness of the latter two, and hence of the secondary market.

Banks are the main holders of Treasury Bills and FIBs for the following reasons:

> Firstly, to fulfil the statutory requirements under the Banking Companies Rules to keep in their own portfolio Approved Government Securities for maintaining the Statutory Liquidity Ratio which is at present 35 per cent of demand and time liabilities of each banking company. Secondly, to earn a regular interest income on their investment in these two securities which accrue to them after every six months. Thirdly, to raise short-term funds against their T-Bills and FIBs holdings under Repo Contract from other Approved Dealers and also sometimes from their non-bank clients. Fourthly, when the funds are not available in Interbank Call Money Market and Repo Market, the banks avail cash accommodation against their auctioned securities holdings from SBP under the prescribed 3-Days Repo Facility.[21]

The rate of return structure is as yet not truly reflective of market conditions. Directed and concessionary credit still form a considerable part of the total credit available each year. This is despite the fact that the government of Pakistan, in its *Economic Survey* for 1994/5, claimed that 'the interest rate structure underwent changes so that it is ultimately determined by free market forces'.[22] According to conventional wisdom, all sorts of direct controls on interest rate movements *must* be removed, and the market, left to itself, is supposed to set the right price of borrowing money. However, because of government intervention in the credit market, different sets of rates of return exist, which do affect the functioning of a (free) money market. In 1991, when the government started its open market operations by issuing debt in the form of Treasury Bills and FIBs, banks found FIBs very lucrative compared to other investment instruments. (See Box 15.5, which presents an extract from one of the most quoted papers on credit rationing, and argues that the free market may not automatically determine the best price for credit, i.e. interest rate.)

Banks had accumulated a great deal of excess liquidity, and a remunerative government-guaranteed investment in the form of the FIBs gave banks somewhere to put their idle funds. Also, after the end of the credit ceilings, banks were motivated to mobilize more deposits in order to be able to lend/invest more, as allowed by the CDR.

One of the reasons why banks were encouraged to invest in FIBs was to replace the government's short-term debt by a longer- and medium-term debt instrument. The government also believed that these banks would develop a secondary market and sell the instruments to the non-banking sector. This did not happen for the reasons listed above, but also because 'banks were building up FIB inventories simply for the purpose of earning a fixed interest income which was payable every six months'.[23] The government was then forced to intervene and impose a ceiling on banks investing more than 15 per cent of their liabilities in government paper of more than one year's maturity.

There has been a continuous differentiation in the rates of return on government debt instruments, and ironically, in the past, the nominal and effective rates of return on short-term government debt instruments have often been much higher than on long-term debt (see Table 15.1). This has been a serious anomaly in the debt structure which should have been based on long-term debt rather than on short-term six-month Treasury Bills (see Chapters 10 and 11). S. A. Meenai and Javed A. Ansari, in *Money and Banking in Pakistan*, present a severe criticism of the market-based monetary policy followed since 1988 in the era of financial liberalization. They argue that the State Bank has 'lost control over the financial system', and that credit planning has become 'meaningless'. They count 13 major problems that have arisen on account of the liberalization since 1988 and are unabashedly critical of the subservience of the State Bank and of all governments since 1988.[24]

15.2 Money Supply and Monetary Expansion

In Section 15.1, we saw how monetary policy and monetary management worked in Pakistan, and how they have evolved over the years, especially since the early 1990s following the financial sector reform programme. In this section, we will briefly look at the numbers and trends in monetary expansion and credit. This section will also help identify the link between money supply and inflation, a theme discussed below. Tables 15.2–15.5 show different features and growth rates of important variables related to the monetary sector.

Total monetary assets in an economy consist of currency in circulation, which is the currency issued by the State Bank of Pakistan, minus the amount held as cash by the banking sector. Adding demand deposits and other deposits with the State Bank, we get the measure of money supply, or M1. Table 15.2 shows the trends in the basic components of M1 over the last decade, as well as that for total monetary assets, M2. M1 is constituted almost equally of currency in circulation and demand deposits. M3, or broad money, includes M2 (and therefore M1 as well), in addition to NDFC Bearer Certificates, deposits in National Saving Schemes and the deposits of the Federal Bank of Cooperatives.

In order to see the causes of the increase in monetary assets, we turn to Table 15.3. Domestic credit expanded a great deal between 1993 and 1998 with private sector credit taking the lead after which it has slowed substantially. Government sector borrowing for budgetary support from the banking sector has grown in leaps and bounds. The annual changes in different definitions of money are shown in Table 15.4 and make an important contribution to the debate about whether 'inflation is always and everywhere a monetary phenomenon' discussed later in this chapter.

Table 15.5 gives us some evidence about the process of financial intermediation/disintermediation in the financial sector. In the 1980s, there was a shift away from time deposits and towards National Saving Schemes as they offered a far better rate of return. Consequently, there was a decline in the ratio of bank deposits to GDP, with demand and time deposits falling from 28.7 per cent of GDP in 1986/7 to 21.5 per cent in 1990/1. Time deposits (TD) fell from 36.1 per cent of monetary assets (M2) in 1985/6 to 25.3 per cent in 1989/90, as people started shifting their deposits from banks to higher-interest-earning sources (Table 15.5). In this period the rise in the M1/M2 ratio also shows the presence of high liquidity in the system, rising from 63.9 per cent in 1983/4 to 74.7 per cent in 1989/90.

15.3 Inflation and its Causes

Pakistan's inflation rate over the years has been an enigma to most analysts. It has historically been rather low (see Table 15.6). A mere 3.3 per cent across the 1960s, it rose to 11.9 per cent on average in the 1970s, and fell again to an average of 7.5 per cent in the 1980s. Only since the early 1990s did inflation become a matter of concern, but then again it fell markedly at the end of the 1990s to around 3 per

Table 15.1
Pakistan: Selected Financial Instruments: Mid-1990s

Description	Rate of return	Tax advantage	Source limits	Comments
Foreign exchange instruments				
Foreign Currency Accounts (FCAs): Time (3, 6, 24, and 36 months) and demand deposits denominated in foreign exchange in domestic banks. Practically no limitations on who can own these accounts. No restrictions on transfer of interest and capital overseas.	Not more than LIBOR plus $\frac{3}{4}$, $\frac{7}{8}$, 1 $\frac{5}{8}$ points for time deposits with maturities equal to/ less than 1, 2, and 3 years, respectively.	Exempt from wealth and income taxes	No questions asked about source of foreign exchange	Banks are obliged to turn over foreign exchange to SBP in exchange for PRs at rate prevailing that day. SBP provides partial exchange risk cover.
Foreign Exchange Bearer Certificates (FEBCs): Three-year rupee obligations of the federal government that can only be purchased with foreign exchange. Can be encashed at any time in either PRs or foreign exchange at the prevailing official rate. Practically no restrictions on overseas transfers. Similar to a zero-coupon bond in the sense that interest is paid at maturity or at time of encashment for each completed one-year period.	The amount payable in PR is 114.5%, 131% and 152% of the face value after one, two, and three years. Interest not prorated within a year.	Exempt from wealth and income taxes	No questions asked about source of foreign exchange	Traded in secondary market at a premium (recently at 6.5%) as a result of remaining foreign exchange restrictions. Both residents and non-residents can use secondary market.
Dollar Bearer Certificates and Foreign Currency Bearer Certificates (DBCs and FCBCs). One-year dollar and other currency (DM, yen, and sterling) obligation of the federal government. Can be encashed in PRs and foreign exchange at prevailing official exchange rate. No restrictions on overseas transfers.	LIBOR plus $\frac{1}{4}$.	Exempt from wealth and income taxes	No questions asked about source of foreign exchange	
Selected rupee denominated instruments				
Special Savings Certificates (SSCs): Three-year obligations (registered as well as bearer) of the federal government introduced in February 1990 They were introduced to replace the Khas Deposits Certificates/accounts that were discontinued by the authorities on the same date. The certificates are issued under the auspices of the Central Directorate of National Savings and marketed by scheduled banks, National Savings Centres, and post offices. There are many other types of savings scheme with characteristics similar to the SSCs.	Interest on these instruments is paid semi-annually and must be drawn on due dates. Interest rates are 11.5% and 12.5% p.a. for first four payments and 14% and 15% p.a. for last two payments for Bearer and Registered Certificates, respectively.	Income from both Registered and Bearer Certificates is free of income tax. Bearer Certificates are also free of *zakat*, while for Registered Certificates *zakat* is deductible for the encashment year.	Registered Certificates are only open to purchase by individuals and local bodies, but there is no upper limit on investment.	Until discontinued, Khaas Savings Certificates constituted the most important source of non-bank budgetary financing. However, the Special Savings Certificates have not proven as popular, since their return is somewhat lower and corporate bodies are excluded.
Market Treasury Bills (TBs): Six-month obligations of the federal government introduced in March 1991 to replace (together with FIBs (see below)) other instruments for bank financing (e.g. ad hoc and on-tap Treasury Bills) and non-bank financing of the budget. The rate of return is determined at an auction held approximately every 25 days.	Rate of return of most recent auctions was in the order of 12% p.a.	For personal income tax purposes, income from TBs is taxed at a flat 10% withheld at source. TBs are exempt from *zakat*.	No restrictions. However, secondary market in TBs is still underdeveloped.	Despite recent moves to make rates more flexible, these rates are controlled by the government via the binding credit/deposit ratio.
Federal Investment Bonds (FIBs) are long-term (3–10 years) obligations of the federal government introduced to replace instruments that were being discontinued. As for TBs, rates of return were to be determined at regularly scheduled auctions.	Rates of return have more or less remained at their coupon rate, which 13% and 15% for three- and ten-year bonds, respectively.	Same as TBs	Same as TBs	

Source: World Bank, *Pakistan: Country Economic Memorandum FY93*, Report No. 11590-Pak (Washington DC: World Bank, 1993).

Table 15.2
Monetary Statistics: 1994–2012 (Rs. m)

(Rs. million)

Last working day	Currency in Circulation 1	Other Deposits with SBP* 2	Currency in tills of Scheduled Banks 3	Banks' Deposits with SBP 4	Reserve Money (M0) (1+2+3+4) 5	Schedule Banks' Demand Deposits** 6	Narrow Money (M1) (1+2+6) 7	Scheduled Banks' time Deposits** 8	Resident Foreign Currency Deposits 9	Broad Money (M2) (7+8+9) 10	Money Multi-plier (10/5) 11
June 1994	184,708	5,506	13,958	54,404	258,576	168,554	358,768	252,497	92,134	703,399	2.72
June 1995	215,579	5,055	16,363	45,855	282,852	202,505	423,139	296,521	105,073	824,733	2.92
June 1996	234,110	6,791	19,328	49,852	310,081	207,108	448,009	344,713	145,958	938,680	3.03
June 1997	244,141	7,135	17,821	77,949	347,046	192,275	443,551	386,801	222,882	1,053,234	3.04
June 1998	272,922	6,412	18,769	71,375	369,478	200,997	480,331	447,433	278,556	1,206,320	3.26
June 1999	287,716	6,212	18,870	85,185	397,983	349,115	643,043	516,586	120,917	1,280,546	3.22
June 2000	355,677	7,959	19,468	114,703	497,807	375,397	739,033	549,124	112,475	1,400,632	2.81
June 2001	375,465	11,292	19,178	127,266	533,201	374,675	761,432	610,458	154,154	1,526,044	2.86
June 2002	433,816	13,847	26,414	110,522	584,599	429,175	876,838	727,076	157,456	1,761,370	3.01
June 2012	1,673,746	8,899	110,055	396,172	2,188,873						

Source: State Bank of Pakistan, *Annual Report* (Karachi: SBP, various years).
* Excluding IMF A/c Nos 1 and 2, SAF loan account, counterpart funds, deposits of foreign central banks, foreign governments, international organizations and deposit money banks.
**Excluding interbank deposits and deposits of central and provincial governments and foreign funds.
Note: The quarter end data relate to last working day whereas monthly data relate to last Thursday/Saturday of the month.

cent in the early 2000s across until 2007/8, when it rose very substantially to as much as 25.3 per cent in August 2008, averaging out at 21 per cent for the fiscal year 2008/9. The inflation rate was in double digits for almost the entire period of the Pakistan People's Party government, which came in to power in March 2008. Different theories of inflation (see Appendix 15.4) give different reasons for why inflation exists, but even though Pakistan's case does cause perplexity, there has been insufficient work on the reasons why prices rise as they do.

Akhtar Hossain, examining historical trends, concludes that 'in Pakistan, real money balances are found to contribute to an acceleration of inflation, while the bond-financed government expenditure is found to have a negative effect on the acceleration of inflation for 1961–88'.[25] After the high fiscal deficits of the late 1980s, however, high inflation was considered to be a key consequence of the irresponsible policies of the government.

While Akhtar Hossain's analysis shows how money affects inflation, the work by Jones and Khilji[26] and by Navqi et al.[27] argues that this is not the case. According to Naqvi et al.

> money supply does not exert changes in the price level. The very small size of the coefficient of the money supply variable and its statistical insignificance contradict the simplistic notion held by some people in Pakistan that inflation is a purely monetarist (or monetary!) phenomenon.[28]

So what is responsible for the double-digit inflation of the 1990s? Work by Hafiz Pasha, Aynul Hasan, and Ashfaque Khan[29] attempted to answer this question, as does the publication by ABN AMRO Bank, partially reproduced in Appendix 15.4. What is interesting from this analysis of the 1990s is that most of these very same reasons have been responsible for the very high inflation rates since 2007/8.

Pasha et al. first examined all the reasons that have been advanced by other scholars for the high inflation in recent years. These include the following:

1. Increases in the price of food, raw materials, fuels, and manufactured goods
2. Inflationary expectations
3. The growth of money supply in relation to GDP
4. Increases in sales and excise taxes
5. Currency depreciation and devaluation
6. Supply shocks like virus-induced reductions in cotton output and weather-induced lower wheat crops
7. Higher agricultural support prices
8. Increases in the prices of utilities
9. Production losses due to power and infrastructural bottlenecks
10. Increases in wages and salaries
11. Insufficiently tight financial policies, with high budget-deficit financing.

Their work takes all these factors into consideration and they then classify the key policy variables in their empirical

Table 15.3
Causative Factors for Changes in Monetary Assets: 1993–2012 (Rs. m)

(Rs. million)

	1993–4	1994–95	1995–96	1996–97	1997–98	1998–99	1999–00	2000–01	2001–02	2011/12
1. Public Sector	28,266	53,086	68,527	80,932	55,898	(74,824)	78,234	(46,731)	22,177	4,983,279
(i) Budgetary support	23,145	36,418	51,726	72,457	48,018	(75,194)cd	39,963c	(32,315)c	14,313	4,636,345
(ii) Commodity operations	6,582	4,733	5,858	5,702	10,585	3,645	40,094	(12,508)	5,331	323,620
(iii) Use of privatization proceeds by Govt./WAPDA	–	14,130	12,000	10,304	1,223	–	–	–	–	32,195
2. Credit to Non-Government Sector (A+B+C)	39,866	69,538	63,428	61,879	84,237	119,214	26,042	69,193	18,994	
(A) Credit to private sector	39,871	59,584	54,749a	61,105b	76,321	84,144	18,080	56,367	52,969	3,516,164
(i) Commercial banks	39,682	46,954	51,938	63,166	65,131	69,279	15,198	54,667	44,867	
(ii) Specialized banks	189	12,630	2,811	(2,061)	11,190	14,865	2,882	1,700	8,102	
(B) Credit to Public Sector Enterprises (PSEs)	(2,793)	5,924	6,142	1,972	8,633	16,176	7,600	20,560	(19,495)	(24,075)
(C) Other financial institutions (SBP credit to NBFIs)	2,788	4,030	2,537	(1,198)	(717)	18,894	362	(7,734)	(14,480)	18,589
3. Counter-part funds	158	(76)	(152)	(119)	86	61	(22)	49	26	(498)
4. Other items (net)	6,309	(28,168)	21,136a	5,153b	26,761	245d	14,456	30,862	(12,040)	(862,318)
5. Domestic credit expansion (1+2+3+4)	74,599	94,380	152,939	147,845	166,982	44,696	118,710	53,373	29,157	7,957,276
	(11.57%)	(13.12%)	(18.80%)	(15.29%)	(14.98%)	(3.49%)	(8.95%)	(3.69%)	(1.95%)	
6. Foreign assets (net)	33,409	26,957	(38,998)	(33,288)	(13,897)	29,529	1,375	72,654	206,168	370,961
7. Monetary expansion (5+6)	108,008	121,337	113,941	114,557	153,085	74,225	120,085	126,027	235,324	8,328,236
	(18.14%)	(17.25%)	(13.82%)	(12.20%)	(14.53%)	(6.15%)	(9.38%)	(9.00%)	(15.42%)	

a Adjusted for Rs. 5,278 million being mark-up debited to borrowers account
b Adjusted for Rs. 8,207 million being mark-up debited to borrowers account
c Adjusted for funds placed in Special Debt Repayment account
d Adjusted for Rs. 28.5 billion on account of Ad hoc Treasury Bills created to offset the government's losses due to the unification of exchange rate

Note: The composition of autonomous bodies has changed over the years. At present WAPDA, OGDC, KE, PTCL, PIA, and Pak Steel are included in the list of autonomous bodies.

Source: State Bank of Pakistan, *Annual Report* (Karachi: SBP, various years).

Table 15.4
Money Supply (M1, M2, M3), 1980–2012 (Rs. Billion) (Rs. billion)

End Period Stocks (last working day basis)	Narrow Money (M1)[a]	% Change	Monetary Assets (M2)[a]	% Change	Broad Money (M3)[a]	% Change
1980/81	73.56	18.7	104.62	13.2	116.80	13.2
1981/82	80.93	10.0	116.51	11.4	133.87	14.4
1982/83	96.54	19.3	146.03	25.3	176.68	32.0
1983/84	103.45	7.2	163.27	11.8	206.90	17.1
1984/85	118.97	15.0	183.91	12.6	238.87	15.5
1985/86	134.83	13.3	211.11	14.8	277.63	16.2
1986/87	159.63	18.4	240.02	13.7	330.87	19.2
1987/88	185.08	15.9	269.51	12.3	392.67	18.7
1988/89	206.36	11.5	290.46	7.8	432.19	10.1
1989/90	240.16	16.4	341.25	17.5	504.16	16.6
1990/91	265.14	10.4	400.64	17.4	569.40	12.9
1991/92	302.91	14.2	505.57	26.2	679.17	19.3
1992/93	327.82	8.2	595.39	17.8	777.37	14.4
1993/94	358.77	9.4	703.4	18.1	922.22	18.6
1994/95	423.14	17.9	824.73	17.2	1,083.73	17.5
1995/96	448.01	5.9	938.68	13.8	1,254.23	15.7
1996/97	443.55	(1.0)	1,053.23	12.2	1,435.48	14.5
1997/98	480.33	8.3	1,206.32	14.5	1,669.23	16.3
1998/99	643.04	33.9	1,280.55	6.2	1,921.47	15.1
1999/2000	739.03	14.9	1,400.63	9.4	2,137.19	11.7
2000/01	761.83	3.1	1,526.04	9.0	2,313.87	8.3
2001/02	876.84	15.1	1,761.37	15.4	2,640.94	14.1
2011/12			7,641.79			

[a]Definition of M1, M2 and M3 are given in the chapter on Money and Credit of the Economic Survey.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

investigation into six demand management policies, as follows:

1. *Supply shocks*. Wherever the total availability of a commodity falls short of its long-run trend due to crop failure, viruses, floods, etc. the price of this sector should rise. The government usually has no control over such matters, especially in the short run.
2. *Monetary policy*. The classic 'quantity theory of money' states that as money increases, so will prices; also, a monetized budget deficit will put further pressure on price (also see Appendix 15.4).
3. *Tax policy*. A rise in, for example, sales taxes and excise duties is usually passed on to the consumers by producers.
4. *External shocks*. As prices abroad rise and as goods are imported into the country, inflation is often imported as well, as these prices are usually a given for a small open economy like Pakistan. Moreover, devaluation and high tariffs also raise the domestic price of commodities.
5. *Pricing policy*. Procurement prices for agricultural products—the prices at which the government buys wheat, cotton, and sugar—are often different from market prices, as the government may want to encourage the growing of certain crops and offer higher prices to farmers and subsidize the cost to (mainly urban) consumers. Higher procurement prices and/or lower subsidies will cause prices to increase. In addition, prices of utilities such as gas, electricity, and fuel are regulated by the government, and may rise, as they have done in Pakistan, in order to be brought in line with world prices under IMF and World Bank pressure.
6. *Expectations*. How people expect the inflation rate to behave in the future will have key consequences for how it actually behaves. Once the expectations of a price rise are built into the mindset of consumers, these expectations are often realized as consumers and producers build in a price rise in their future formulations. It is also more difficult for individuals to revise their expectations downwards; this takes a much longer time than adjusting expectations upwards.

The mechanism through which inflation is reflected in the wholesale price index (WPI) can be seen in Figure 15.1. The empirical simulation conducted by Hafiz Pasha et al. produced the following results: the supply shock has the greatest negative effect on food prices (84.8 per cent), and procurement prices for wheat are also highly significant; sales taxes and excise duties affect manufactured products, and imported commodities influence raw material prices by 50 per cent and manufactured prices by 30 per cent; the role of inflationary expectations is also very significant, causing prices to rise. More interestingly, the study found that monetary supply, contrary to the conventional view, is not translated into increasing overall inflation, essentially

Table 15.5
Key Indicators of Pakistan's Financial Development

(Per cent)

Year	M2/GDP	M1/M2	DD+TD/M2	TD/M2	LRM
1980–81	37.6	70.3	66.2	29.7	9.5
1981–82	35.9	69.5	67.2	30.5	7.1
1982–83	40.1	66.1	68.3	33.9	15.1
1983–84	38.9	63.4	67.7	36.6	12.6
1984–85	39.0	64.7	68.9	35.3	4.6
1985–86	41.0	63.9	69.6	36.1	6.6
1986–87	41.9	66.5	68.4	33.5	5.7
1987–88	33.7	68.7	67.0	31.3	3.0
1988–89	37.7	72.6	65.3	29.0	2.6
1989–90	39.9	70.0	65.6	29.6	3.3
1990–91	39.2	70.4	65.1	31.5	3.3
1991–92	41.7	66.2	69.3	31.6	5.0
1992–93	44.4	59.9	71.2	34.6	1.8
1993–94	44.7	55.1	73.0	35.9	9.9
1994–95	43.8	51.0	73.3	36.0	10.2
1995–96	43.3	51.3	74.3	36.7	7.4
1996–97	43.8	42.1	76.8	36.7	4.5
1997–98	45.1	39.8	77.4	37.1	3.3
1998–99	43.6	50.2	77.5	40.3	6.3
1999–2000	44.5	52.8	74.6	39.2	5.0
2000–01	44.6	49.9	75.4	40.0	7.9
2001–02	48.5	49.8	75.4	41.3	16.8

TD = Time Deposits.
DD = Demand Deposits.
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

because monetary expansion does not have a significant impact on food prices, which form 51 per cent of the Wholesale Price Index. This finding contradicts the view popularized by the IMF and World Bank, and repeated verbatim by the government of Pakistan. In addition, another popularly held view, that the floods and commodity shortages of cotton and wheat in 1992/3 may have caused double-digit inflation, was not borne out by their study.

In summary then, for Hafiz Pasha et al. the key factor explaining the inflation rate in Pakistan in the mid-1990s is neither demand management policy nor supply shocks, but interestingly enough, procurement prices, particularly that of wheat, and the administered prices of fuel, gas, and electricity.[30] In addition, an increase in indirect taxes helps to aggravate the situation. The authors argue that many of these measures which have caused the relatively high inflation of recent years are a key constituent of the IMF and World Bank Structural Adjustment Programmes. However, Part VI of this book in which the Structural Adjustment Programme is discussed in detail, shows that one of the key targets of the programme was a fall in the inflation rate, not its *increase*.

While the inflation rate was particularly high during the 1990s, for reasons that have been identified by Pasha, et al. it fell to very low levels after 1998/9. In addition to the factors that have been identified above—the rise in administered prices particularly of utilities and of procurement prices—

Table 15.6 (Panel a)
Historical WPI, CPI, and Sectoral Inflation Rates

Years	WPI General	CPI General	WPI Food	WPI Raw materials	WPI Manufacturing	WPI Fuel lube
1960–1969	2.6	3.3	2.6	2.0	3.4	3.3
1970–1979	13.5	11.9	13.4	12.9	11.7	17.8
1980–1989	7.1	7.5	7.2	6.9	7.0	7.2
July to Jan. 1994/5	18.9	n.a	n.a	n.a	n.a	n.a

(Panel b)
Historical CPI, WPI, SPI, and GDP Deflator

Fiscal Year	Consumer Price Index	Wholesale Price Index	Sensitive Price Index	GDP Deflator
1990–91	12.66	11.73	12.59	-
1991–92	10.58	9.84	10.54	10.07
1992–93	9.83	7.36	10.71	8.89
1993–94	11.27	16.40	11.79	12.47
1994–95	13.02	16.00	15.01	13.78
1995–96	10.79	11.10	10.71	8.28
1996–97	11.80	13.01	12.45	14.63
1997–98	7.81	6.58	7.35	6.55
1998–99	5.74	6.35	6.44	5.85
1999–00	3.58	1.77	1.83	2.78
2000–01	4.41	6.21	4.84	6.72
2001–02	3.54	2.08	3.37	2.49
2002–03	3.10	5.57	3.58	4.42
2003–04	4.57	7.91	6.83	7.74
2004–05	9.28	6.75	11.55	7.02
2005–06	7.92	10.10	7.02	10.49
2006–07	7.77	6.94	10.82	7.70
2007–08	12.00	16.64	16.81	16.21
2008–09	17.03	18.93	21.14	20.00
2009–10	10.10	13.85	12.93	12.43
2010–11	13.66	21.25	16.57	18.21
2011–12^P	10.84	11.24	6.72	9.68

^{P} Provisional July 2011 to April 2012
Note: (I) Base year has been changed to 2007–08 figures 2008–09 to 2011–12 are on 2007–08 base
Note: (II) WPI, CPI, and SPI Base Year = 1990–91 series have been converted into Base Year 2000–01.
(III) GDP Deflator is with 1999–2000 = 100 as base year.

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

there was substantial devaluation of the Pakistani rupee throughout the 1990s. From a rate of Rs. 25 to one US dollar in the early 1990s, one US dollar was being exchanged for around Rs. 60 in 2001 (after which it fell again), and this may have also had an impact of pass-through inflation. The reasons why the inflation rate started to fall after 1998 are related to the considerable slowing down of aggregate demand following the nuclear tests, General Musharraf's

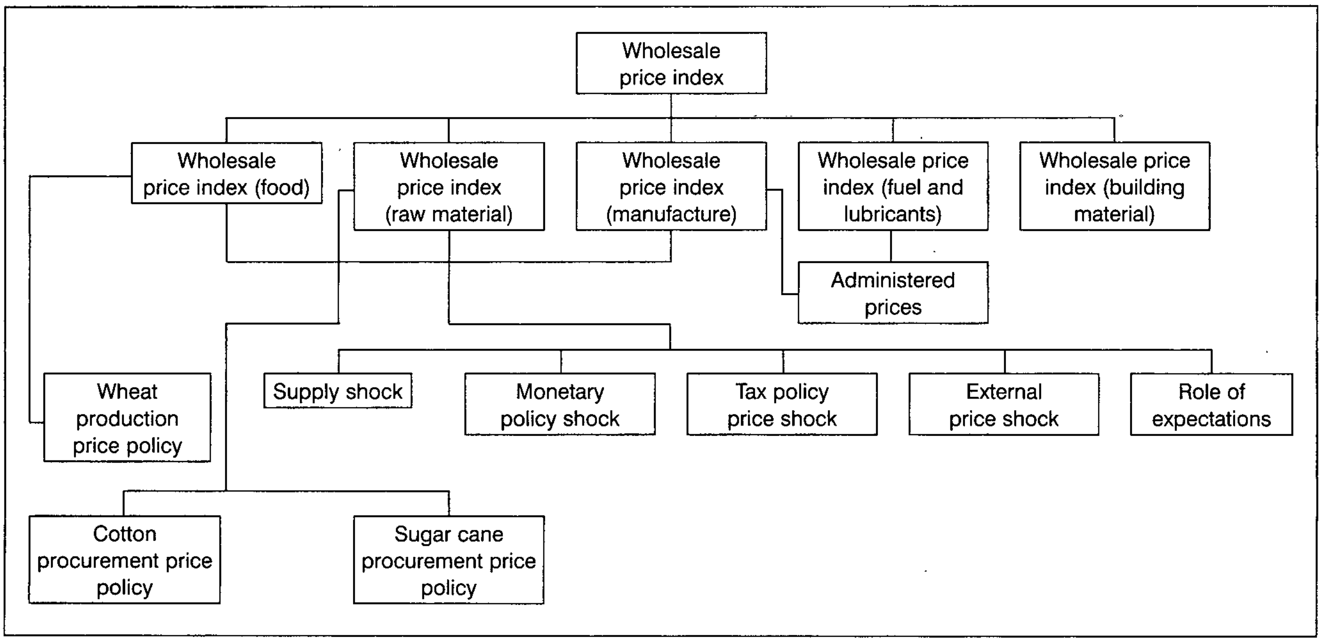

Figure 15.1
Schematic Diagram Explaining Causes of Inflation in Pakistan

Source: Pasha, Hafiz et al. 'What Explains the Current High Rate of Inflation in Pakistan?', *Pakistan Development Review*, vol. 34, no. 4, 1995.

coup and 9/11—see Chapter 18—when the overall growth rate also contracted sharply and while not formally in a recession, little investment or growth took place after 1998. The period since 2007/8 is marked for its unprecedented and chronic inflation rates. From having been a low-inflation country, as was the rest of South Asia, Pakistan became not just a double-digit inflation country, but one where the inflation rate seemed to be stuck near 20 per cent annually. By all accounts, this level of inflation as well as its persistence, was a new and more recent occurrence In Pakistan.

If one examines the full tenure of the Pakistan People's Party government since March 2008 as discussed more fully in Chapter 18, the factor which stands out most, is that for almost every month of its tenure, inflation was in double-digits. There are a number of reasons, many extraneous to the handling of the economy by the government, which caused prices to be stuck at such high levels. A number of events took place in the period 2008–12, which have had an impact on Pakistan's economy and also on the price level and help us explain the persistent levels of high inflation. They also give rise to a critique of the notion that inflation is always and everywhere caused by monetary policy, questioning the core of the monetarists' logic.

In early 2007 the price of a barrel of oil was $60, but rose to $92 by October of that year. Prices for oil rose in early 2008 to set a record high on 29 February 2008 of $103.05. They rose again in March breaking many records and finally touched $141.7 on 27 June and there were predictions that the international price of oil could reach $170 by the end of that summer. However, by the end of October 2008, prices had fallen to between $60–70, and in the years after 2009, have moved largely upwards, settling somewhere above $100 or thereabouts. The consequences of a rise in petroleum prices are not difficult to understand, and while the global recession caused a serious downturn in Europe and the US, it resulted in prices rising globally. In Pakistan, not surprisingly, the high oil prices resulted in inflation being passed on to the consumers, but there was also a strong element of mismanagement involved caused by domestic political factors. In Pakistan in 2012, oil prices were deregulated with domestic prices being adjusted by the government every two weeks, with plans to allow even more frequent adjustments. However, in 2007 once a Caretaker government was in place in Pakistan, with General Pervez Musharraf as President hoping that the political parties he had supported would win the anticipated January 2008 elections, the international oil price rises were not passed on to the Pakistani consumers, as they should have been, in fear of a negative reaction by the voters. The Musharraf-backed and supported Caretaker government refused to pass on the prices and maintained an artificial lid on domestic prices. Once the elections had been held in February 2008 and a new government sworn in, these prices could no longer be held back, and thus began the more natural policy of passing on international oil price rises to domestic consumers. With oil at its historic highs and having been at persistent highs since 2008, domestic prices of petroleum have also risen to their highest ever. This has been one of the most important factors of inflation in Pakistan since 2008.

While the price of oil has risen in the past, the oil price rise this time resulted in the global diversion of food stuff from consumption to the production of biofuels to compete with

natural petroleum. This was one reason for food prices to rise globally after 2008 as well. World food prices rose quite markedly in 2007 and 2008 and between 2006 and 2008 average world prices for rice rose by 217 per cent, wheat by 136 per cent, corn by 125 per cent and soybeans by 107 per cent. In late April 2008 rice prices hit 24 cents (US) per US pound, more than doubling the price in just seven months. With lower production in some countries due to climate change and other factors, food inflation resulted in prices rising globally. In Pakistan, as well, food inflation, along with the rise in petroleum prices, became the main drivers of domestic inflation. After the dramatic rises in both petroleum and food prices, both settled down, albeit to higher than pre-boom levels.

An additional factor which resulted in domestic inflation in Pakistan was on account of the more than doubling of wheat and rice support prices paid to farmers. Farmers received a huge bonus as these prices were converted to higher incomes, but this affected the overall price of food commodities, affecting food prices. Not only does food have a large weight in the calculation of the Consumer Price Index, but food prices also affect the poor and fixed income segments who are unable to adjust their incomes to the rise in food prices. Food prices are also politically very sensitive and governments often provide subsidies to keep food products accessible for consumers. In addition to these factors, floods in 2010 and 2011, also affected the supply of foodstuffs locally, having an impact on food prices, and hence on the inflation rate overall.

Clearly, as we can see, since 2008 when the inflation rate was stuck at a double-digit level, a number of international factors had had made the domestic inflation what it was. Money supply and monetary policy seem to be conspicuous by their absence in this equation—see Box 15.7 and 15.8.

15.4 The Low Savings Rate

Table 15.7 shows that Pakistan's national savings rate during the 1970s was a mere 11.2 per cent, rising to 14.8 per cent, during the 1980s but then falling again to 13.8 per cent for the 1990s, rising again in the boom of the 2000s, to settle at 10.7 per cent in 2011/12, perhaps the lowest of all time. Not surprisingly, even when it was somewhat higher, Pakistan's savings rate was considered to be a very low rate by the standards of comparable economies, where a rate of around 20 per cent is common. This lack of savings is supposed to be 'one of the basic structural macroeconomic problems'[31] faced by the country. As Table 15.8 shows, savings are generated mainly in the household and unincorporated private enterprises sector, and government savings have been, for the most part, either very low or negative, a situation which changed when loss-making public enterprises had been sold off, but continues now with still many loss-making public enterprises requiring support from government finances.

There are essentially two major schools of thought which explain why low levels of savings exist. The financial repression school argues that low or negative real interest rates, which are often caused by arbitrarily set government ceilings on nominal interest rates, along with high and variable inflation rates 'are the major impediments to savings, financial deepening, capital formation, and growth'.[32] This view seems to be the one favoured by the authorities in Pakistan, as much of Section 15.1 shows. The solution, as has been also implemented in Pakistan, is to place interest rates in a free market environment, so that they can find their own 'equilibrium' levels. The financial structure school believes that, especially in underdeveloped countries, low savings, investment, and growth exist because of the lack of depth and breadth in the financial sector, since financial assets, markets, and institutions are few and not well developed. Not surprisingly, according to this view, an extended network of financial institutions and the availability of different types of assets and instruments are supposed to have a positive impact on savings and investment.

Some evidence from Pakistan[33] shows that both schools of thought are supported. It is believed that an increase in the real interest rate will stimulate aggregate savings in Pakistan as people move out of non-financial assets and into the financial sector, however, as we have shown in Chapter 14, those with access to financial services in Pakistan are very few compared to those who are excluded. Moreover, as financial development takes place and more institutions and instruments are made available, aggregate savings are also supposed to increase. However, in 2004, as we show in earlier sections, both the interest rate and the rate of inflation were very low and quite probably, the real rate of interest was negative. While this induced people (mainly consumers) to borrow, it did inhibit savers who do not find financial instruments lucrative forms of investment. This gives rise to speculation in the stock market and the real estate market,

Table 15.7
Savings as a percentage of GDP: 1970s–2012^P

	1970s*	1980s*	1990s*	2000s*	2010/11	2011/12^P
National Savings	11.2	14.8	13.8	14.7	13.2	10.7
Foreign Savings	5.8	3.9	4.6	0.9	–0.1	1.8
Domestic Savings	7.4	7.7	14	16.1	13.3	8.9

*Average of Decade; ^{P} = Provisional
Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Box 15.7

What Does Monetary Policy Do?

Mohiuddin Aazim examines the role of monetary policy in Pakistan suggesting that it might have numerous objectives.

An unusual thing happened last fiscal year. The private sector businesses retired in the second half of the year about 79 per cent of the bank loans they had taken in the first six months, and made no additional borrowing.

On the other hand, over the same comparable period, credit flow to non-bank finance institutions (NBFC) quadrupled, creating a big imbalance between lending to PSBs (private sector businesses) and NBFCs, both of which are part of the private sector.

The State Bank of Pakistan (SBP) in its monetary policy statement of 10 August came up with explanations. But the fact that inflation remained in double digits in FY12 despite a minimal share of private sector credit intake in overall money supply has regenerated some old debates. Is inflation really a monetary phenomenon—a product of too much money chasing too few goods? Is monetary policy focussed on inflation-fighting losing importance? And, should central banks leave inflation worries behind and support government overspendings to spur economic growth?

"These days even financial markets are telling us that we should be focused on jobs and growth", wrote Paul Krugman in one of his columns in New York Times in July this year. He was referring to the fact that investors are now investing in US treasuries at zero and even sub-zero rates and such low-cost borrowings could be well utilized for financing public sector projects now to obtain a higher economic growth later on. A higher than estimated growth of 1.7 per cent in US GDP in April–June proves that government borrowings from the banking system actually pay off.

In the last few years, Pakistan economy has expanded at a much slower rate than required to reduce poverty, feed, clothe and provide medical care to 180 million people.

Instead of trying to accelerate economic growth through liberal private sector lending, banks have largely remained averse to it with the result that industrial output has either declined (as in FY10) or has increased slightly above one per cent (as in FY11 and FY12).

In a market-driven economy, a part of the capitalist world economic order, one can understand banks' failure in this regard. But a bigger question is: has the domestic monetary policy been of any help in ensuring larger private sector credit off-takes to enable businesses to enhance productivity?

The SBP has the statutory authority and obligation to do whatever it can "to regulate the monetary and credit system of Pakistan and to foster its growth in the best national interest with a view to securing monetary stability and fuller utilization of the country's productive resources."

The monetary policy is one key instrument to be employed to obtain this statutory goal. Senior SBP officials claim they design the monetary policy keeping in view 'this somewhat very broad and unique objective' in mind.

But has the SBP been regulating the banking system in a manner to achieve 'fuller utilization of the country's productive resources'?

In its monetary policy statement issued on 10 August the SBP detailed the reasons for lowest-ever actual lending to private sector businesses—Rs. 18.3bn only out of the total private sector credit of Rs. 235 billion, the bulk of which Rs. 121bn went to non-bank finance companies.

However, the SBP authorities did not find convenient to explain this development in terms of demand-side issues and merely pointed out that banks were rather more interested in investing money in government papers. The nation expected that the central bank should have informed what it had done to correct the situation.

The cost of external financing has reduced in recent years as a percentage of overall operational cost of businesses because of pricier energy inputs, imported inflation, and handy internal financing available to highly profitable enterprises.

Businessmen say that compared to 1990s when bank borrowings of even the most efficient industries accounted for at least one-fourth of the overall cost of business, such borrowings now merely make up 10–15 per cent of operational expenses. This means that by steering interest rates in one direction or the other, the SBP influences a nominal change in the cost of the goods and services produced by a company—and by extension on cost-push inflation in the country.

"Keeping this in mind we are trying to remodel our monetary policy with a view to making it more responsive to the ground realities," a senior central banker told Dawn when asked what the SBP was doing to avoid harming industrial growth in its fight against inflation. "Unlike central banks of advanced economies, our monetary policy is not built upon the paradigm of inflation targeting. It rather aims at meeting the dual objective of ensuring sufficient economic growth while keeping inflation under check."

Central bankers generally agree that avoiding a deep cut in policy rate fearing faster growth in money creation and its impact on inflation has become a moot point even amongst them. If net credit to private sector businesses went down to just Rs. 18.3 billion or about two per cent of the Rs. 946 billion worth of money supply (M2) the argument that availability of cheaper finance to businesses may push up prices, crumbles.

The monetary policy statement of 10 August does not mention this fact very clearly, but as it highlights other factors responsible for inflation like prices of imported goods, excessive government borrowings, withdrawal of subsidies, administered prices, energy crisis, etc. in detail, it is easy to deduce what the SBP is actually pointing out.

Even excessive government borrowing cannot be blamed for causing too much money chasing too few goods phenomenon "because, after all, government uses all the money borrowed through PIBs, TBs or even national saving schemes either to repay domestic and foreign debts or to finance its expenses. And financing of expenses, however questionable they may be, plays a role in growth—and is quite important when exports are falling and industrial growth is stalled," says a former advisor of SBP. "Government's overspending (which creates fiscal deficit) is basically what? It is income for thousands of government contractors and sub-

contractors and tens of thousands of government employees or for state-owned enterprises. All this, in turn, becomes part of GDP."

Commercial bankers defend their overinvestment in government papers on the same ground. They say if banks stop lending to government when demand for private sector credit is low it would completely ruin the economy. Government officials, however, have a different point of view. "Why can banks and leasing companies not make money by doing more business in agriculture sector or with SMEs? Why are they contended with earnings on bills and bonds?" questions an official of the Ministry of Food Security and Research, citing examples of how banks and leasing companies can make quick bucks if they lend for agricultural development.

"If this is what it is, then why fear slashing interest rates? It is not going to push up inflation. It will rather contain it by improving supplies of goods. But, of course, it will reduce profitability of those who earn not by producing anything but by actually blocking credit-flows to productive sectors."

Source: Aazim, Mohiuddin, 'Remodelling the monetary policy', *Dawn*, Economic and Business Review, Karachi, 3–9 September 2012. This is a slightly edited version of the original.

where prices are pushed up. However, savings do not take place. In the period 2008–12, when the inflation rate was in the high teens or even 20 per cent on an annual basis, and the rate of interest less than that, and the real rate of interest negative, there were few incentives to save. Saving will be a cost to those who want to hold on to money at a time of high inflation, given the lower interest rate.

A number of studies have been conducted in Pakistan to investigate why the savings rate is so low. Appendix 15.5 shows the effects of fourteen different variables on the savings rate. Work by Siddiqui and Siddiqui[34] has shown that, as income increases, savings will also increase—this was found to be a positive and significant relationship, and might explain the rise in the savings rate in the Musharraf–Aziz years of 1999–2008. The effect of the dependency ratio was seen to be negative, but not very significant, implying that an increase in the dependency ratio would cause savings to fall, but not by very much. Zafar Iqbal, however, finds a strong negative effect of the dependency ratio on savings, showing that 'as the rapidly growing share of dependants in the total population tends to consume more than they produce, there is a consequent reduction in household savings'.[35] However,

Table 15.8
Capital Accounts of the Public and Private Sectors (Period Averages, % of GDP)

	1970–1990	1970–1977	1978–1981	1982–1986	1987–1990
National savings	13.12	10.43	15.17	14.83	14.31
Public saving	1.12	0.42	2.30	1.74	0.55
Government saving	0.46	0.88	1.90	0.18	–1.46
Public enterprise saving	0.55	0.40	0.54	0.75	13.08
Private saving	12.00	10.01	12.87	13.09	13.75
Corporate saving	0.50	0.60	0.32	0.36	0.68
Household saving	11.50	9.41	12.55	12.73	13.08
Gross domestic investment	18.28	17.28	19.39	18.68	18.67
Public investment	9.94	9.10	11.33	10.30	9.79
Government investment	3.15	2.78	3.18	3.50	3.41
Household investment	0.73	0.64	0.90	0.90	0.49
Private investment	8.34	8.18	8.06	8.38	8.88
Corporate investment	0.74	0.86	0.46	0.48	1.11
Household investment	7.60	7.33	7.61	7.90	7.77
Saving – Investment (S–I)	–5.16	–6.85	–4.23	–3.85	–4.37
Foreign capital inflow	5.16	6.85	4.23	3.85	4.37
Public sector	2.67	4.30	2.67	0.93	1.51
Private sector	2.49	2.50	1.56	2.92	2.86
Recorded	0.94	0.56	0.80	1.51	1.11
Unrecorded	1.55	1.94	0.76	1.41	1.75
Resource transfer to the public sector	6.15	4.32	6.36	7.63	7.73

Source: Naqvi, S. N. H. and Khwaja Sarmad, 'External Shocks and Domestic Adjustments: Pakistan's Case 1970–1990', mimeo, University Grants Commission (Islamabad: OUP, 1997), 47.

Box 15.8

Managing Easy Monetary Policy

Sajjad Akhtar analyses Pakistan's monetary policy:

With two consecutive downward adjustments of policy rates, many see it as a beginning of an era of easy monetary policy till the country is in an election mode. While the jury is still out whether the easing will fuel inflation more than it will help growth, managing easy monetary policy implies that boost to growth outweighs the costs in terms of actual inflation and inflationary expectations.

A stylistic overview of how SBP conducted the tightening and easing cycle in the last ten years will help to assess how long or short were these cycles and the limits of these cycles. The last time the policy rate was 12 per cent was in June/July 2008, three years ago. It was 14 per cent in June 2001. In a matter of 18 months, it was brought down to 7.5 per cent. It remained there for the next two and half years when in April 2005 it was increased to 9.0 per cent. It took 4 years for SBP to raise it to 14 per cent by April 2009. Thus one can infer that in the last 10 years, easing cycles were much shorter and faster than the tightening cycles.

Of course, in a two-way cause and effect environment, inflationary trends and expectations, growth prospects, interest rate parities, and the exchange rate also matter in determining the length and extent of these cycles. However, the length of the cycles suggests that interest rate policy has remained pro-growth more than it has remained anti-inflationary, except in the last 3 years under the IMF programme. Given that imported inflation and currency under pressure is likely to transmit rapidly to local inflation, along with supply bottlenecks there is not enough room to emulate the previous easing cycle of 18 months unless SBP succumbs to political pressure.

Does the previous easing cycle carry some lessons for promoting growth? Do lower interest rates raise growth and to what extent? If the impact is positive than what is the nature and composition of growth? Does it promote exports, specifically of manufactured exports, or much maligned consumption growth in durables and import intensive manufactures?

The writer conducted a back of the envelope exercise and based on the last 5 years, macro data, it revealed that 1 percentage point (i.e. 100 basis point) decline in policy rate increases the annual growth rate in manufacturing by 0.20 per cent and growth rate of GDP by 0.27 per cent. In case of manufacturing, its historical performance was instrumental in determining the positive impact of the interest rate, while the GDP growth rate technically followed a random walk.

Furthermore, it indicated that to achieve the manufacturing and GDP 2011–12 growth targets, lowering interest rates by a further 200 and 100 basis points, can be conducive (do not equate it with the word 'ensure') for achieving this year's targets. Ideally, this is the extent to which the easing cycle should go during the year, unless there is a compelling favourable external and internal economic environment.

Since it is a back of the envelope exercise lending rates impact on growth rate should not be linearly extrapolated to achieve an above target growth rate. The trade-off between growth and inflation comes out very clearly even in this simple exercise. A 100-basis point decrease in policy rate increases CPI by 0.24 percentage points but after a lag of 3 months. What are the observed transmission impacts on growth that can be attributed to the easy monetary policy during 2001–05?

A) Consumer credit is fairly sensitive to lower interest rates. This type of credit was widely used to buy durables, and transport equipment, specifically automobiles and two-wheelers in the 2001–08 era. Cheap credit generated demand of these import intensive durables and did help local manufacturing and employment, but also increases the import bill. At the time, increased FDI did help to cushion the increasing import bill, but in times of falling FDI cheap consumer credit spent on import intensive durables can destabilize the already precarious BoP situation.

B) Housing is another sector that receives a boost from lower interest rates. The forward linkages of a booming housing sector in terms of pulling along another 14–17 sub-sectors in the manufacturing sector is well documented. However, it is a resource-intensive sector, in terms of cement, iron and steel, wood, plastics, and glass. Thus in an environment of higher, or at best, fluctuating world-wide raw material demand, any increase in domestic demand due to lower interest rates will translate faster into higher prices than rapid increase (punctured by energy shortages) in output. In the previous easing interest-rate cycle, a stable exchange rate, low inflation, uninterrupted energy supply and stable international prices helped to create a mini housing boom in the construction related industries.

C) Three types of speculative unproductive investments are lucrative for speculators in time of falling interest rates and are intimately linked to increased liquidity and credit 'fungibility' in the economy. Property: Once there is enough liquidity in the system at low interest rates, investment into property fuels a vicious cycle of speculation into property and housing values, backed by a weak regulatory framework and poor documentation. Increasing remittances are already sustaining the private property, housing and construction activities (maybe not at the scale of earlier easing or to the extent the populist government would want to showcase) and further easing of interest rates would create a boom-and-bust cycle as witnessed during the 2001–2008. A caveat is in order here. The previous property boom was also somewhat supported by financial transfers due to war on terror, an internationally low interest rate environment, accompanied by excess international liquidity. Stocks: Investment in the stock exchange in times of low interest is attractive on two counts. It increases the differential between the interest rates on borrowed funds by speculators and the rate of return (capital gains) on short-term investment. Secondly, it also improves the balance sheet of listed companies improving their P/E ratios. To the extent that the rising stock market is able to attract portfolio investment from foreign investors, it helps the foreign exchange reserves. Will the current easing cycle, speedup the flow of portfolio investment as it did during mid decade and took flight out in 2008? In spite of sovereign debt crisis in the West, the current easing cycle could boost portfolio investment, as rising prices increase the profitability of listed companies, but the structural bottlenecks in the economy and

the elevated risks of depreciating currency do not favour a repeat of the 2002–2006 scenario. The foreign investor may wait for another round of easing and the BoP situation by March 2012. Speculative Imports and inventory investment: In times of weak exchange rate, and high domestic inflation, low interest rates also encourage speculative imports. Thus SBP needs to keep a watch on above normal short or medium term trends in imports, especially in case of consumer goods. Inventory investment is also attractive in times of low interest rates and high inflation, but can be instrumental in boosting production if there is sufficient under capacity utilization in the manufacturing sector. But given the rigidities in agriculture production, inventory investment is likely to push prices rather than output.

A similar back of the envelope exercise linking growth in exports to policy rate could not be conducted due to lack of data. However a dated work by the writer indicated that one per cent increase in incentive index (composed of customs rebate and export refinance rates) only increased export by 0.7 per cent to the US, while it had no impact on exports to Germany, Britain, and Japan.

Lastly, the issue of 'fungibility' of easy credit in the transmission mechanism is a formidable challenge in effectively managing an easy monetary policy. In other words it is the recorded/perceived versus the actual use of credit. Are there checks in place that ensure synchronization of recorded with the actual use of credit? How does one ensure that loan to agriculturists does not increase his capacity to hoard wheat rather than buy inputs to bring additional land under cultivation? Sectoral classification of credit, however tight, can blur the end-use purpose of loans. Loans to cement stockiest can be conveniently classified as loans to the construction industry. The 'fungibility' issue cannot be dismissed lightly in this economy, where owners of floor-mills, cotton ginning operations, petrol pumps, fertilizer, steel, ghee, and sugar stockists yield directly or indirectly considerable clout in the national and provincial assemblies. Unfortunately no central bank can ensure perfect synchronisation of millions of loan accounts and the extent of 'dis-intermediation' is a function of the presence of opportunities to make a quick return in the market.

Source: Akhtar, Sajjad, 'Managing Easy Monetary Policy, *Business Recorder*, Karachi, 2 November 2011. The article has been slightly edited from the original.

he also confirms the positive relationship between the domestic real interest rate and household savings. Inflation and the expectation of inflation in the future are negatively related to household savings: the expectation of higher inflation in the future means that households will substitute future consumption by present consumption, lowering the savings rate.

At a more macro level, Zafar Iqbal's results show that private capital outflows and the foreign interest rate have a 'strong negative' effect on household savings, 'which suggests that unfavourable circumstances, political unrest, and financial repression in Pakistan provoke people to transfer their resources abroad to a safer place'.[36] This might also explain the low savings rate in the 2008–12 period, when all these factors affected Pakistan. Moreover, rising prices are also a disincentive to save, especially when higher prices are anticipated in the future. Export earnings, interestingly, have a strong positive effect on national savings, as exports increase the propensity to save as compared to other sectors.

One of the more interesting findings related to savings is that of Shabbir and Mahmood, who show that 'foreign financial inflows may discourage domestic public and/or private saving behaviour and resource mobilization effects'.[37] The theory suggests that, if savings are low in a country and there is a resource gap between investment and savings, foreign capital inflows can fill that gap, ostensibly increasing growth. In Pakistan's case, we see that foreign aid impedes domestic savings growth and mobilization. Foreign capital seems to *substitute rather than augment* domestic savings on two accounts: '(a) foreign capital inflows would lead to government being less enthusiastic about its resource generation efforts, the nation could increase its consumption expenditure and/or liberalize imports and (b) to the extent that saving is determined by available investment opportunities, by crowding out domestic investment, foreign portfolio investment could cause savings to fall'.[38] At a household level, Zafar Iqbal[39] found that easily available credit from banks discourages the efforts of households to generate their own savings, a result also confirmed by N. H. Naqvi and Khwaja Sarmad.[40] Khan et al. support Shabbir and Mahmood's findings by showing that a 1 per cent increase in foreign capital inflows cuts national savings by 0.21 per cent. 'The negative impact of foreign capital inflows suggests that for the most part, external assistance has been used for consumption purposes and that it has discouraged savings efforts by both the private and public sector, in Pakistan.'[41]

To emphasize the complicated reasons for persistent low savings, and the extent to which the conclusions of each researcher vary, we cite some of the results of Ashfaque Khan et al. For them, the most important factors affecting national savings were per capita income, the dependency ratio, the real interest rate, and foreign capital inflows. They found that as per capita income increased, due to either a slowdown in the population growth rate or a higher real GNP growth rate, savings would rise. However, unlike the other studies cited, for Khan et al. 'the high dependency ratio caused by the rapid increase in population has been the most important factor causing the savings rate to remain depressed'.[42]

While there is some debate over why the savings rate in Pakistan is so low, the consensus rests on a few points:

1. There is a strong correlation between household savings and the real rate of return on financial assets, which means that the government's policy of keeping real interest rates low—financial repression—has helped reduce the level of domestic savings. However, as we have shown in Chapter 14, only a small, albeit perhaps prosperous, segment of Pakistan uses formal financial institutions, as well as savings—see below.
2. The greater availability and ease of access to financial institutions, markets, and instruments should cause the savings rate to increase.
3. Foreign capital inflows—foreign aid—which were supposed to fill the savings–investment gap, have actually had a negative impact on domestic savings and have not acted as a catalyst to increase national savings.
4. Similar results regarding household savings and the availability of bank credit have been observed.
5. Inflation and uncertainty about the future—as has been common in Pakistan—has been responsible for capital flight and greater consumption than is perhaps warranted. This must count as one of the more important factors for the low savings rate specific to Pakistan.

Other factors that may be responsible include cultural factors, such as where savings in the form of assets, particularly gold and jewellery, substitute for financial savings, is very probable in Pakistan. Due to the lack of awareness and use of banks, and with greater emphasis on savings in real assets, the real (as opposed to financial) savings rate in Pakistan is probably higher. Moreover, the presence of a very large informal financial sector suggests that the official savings rate does not capture the entire amount of money actually saved.

Recent evidence from the *Access to Finance Survey* referred to in Chapter 14 with regard to the savings rate are worth quoting.[43] According to the Study, only half of the population saves, whether in the formal or informal sector, and among those who save, only 14.9 per cent of savers go to formal financial institutions, and around 63.6 per cent of Pakistanis save at home, in cash or jewellery, or in assets such as land and livestock. After the main category of savings at home, the next most popular category in the informal sector is those who save in 'committees' or *bisees*, around 25.7 per cent of those who save in the informal sector, followed by savings with family and friends (6.7 per cent).[44] The main purpose of savings is consumption smoothening, not investment.

15.5 Summary and Further Reading

15.5.1 Summary

For some economists, money and monetary policy are the key determinants of economic activity. In Pakistan, until recently, monetary policy was closely controlled by the government and the market was almost non-existent when it came to determining the cost and allocation of money in the economy. Since 1991 a more market-based approach has been followed, with the regular auction of Treasury Bills influencing, if not determining, the rate of interest. However, by all standards, the money market is still extremely underdeveloped in Pakistan, and for some economists, this is one reason why the economy has not functioned well.

Money supply and its annual expansion are supposed to be one of the key determinants of the price level in the economy. We have examined a large literature with respect to Pakistan and find that this is not the case. Inflation in Pakistan occurs for numerous structural reasons, and because of the frequent escalation in administered prices by government. In fact, there is almost no relationship between price levels and the growth of money in the economy.

Pakistan's savings rate, currently of around 11 per cent in 2011, down from 16.5 per cent of GDP in 2000/1, is also considered to be a key deterrent to economic expansion, especially since most East Asian economies have savings rates almost double Pakistan's. One school of thought argues that savings are low due to financial repression, i.e. the market does not play the dominant role in the financial system, while another view argues that savings stay low because the financial structure is undeveloped. We have examined a large number of causative factors for the low savings rate, and find that neither the financial repression nor the financial structure school provides an adequate explanation. Cultural factors, too, may suggest why the financial savings rate is low.

15.5.2 Further Reading

The works listed in the Notes should provide sufficient sources for those who want to examine the monetary sector and monetary policy in Pakistan. In addition, the *Journal of the Institute of Bankers in Pakistan* and articles in the press should be consulted regularly for recent changes, along with the State Bank of Pakistan's *Annual Reports*; also see *The Pakistan Development Review* for frequent analysis on these themes. The recently revised and expanded *Money and Banking in Pakistan*, (Fifth Edition) by S. A. Meenai and Javed A. Ansari (Karachi: Oxford University Press, 2004), and the State Bank of Pakistan's *Pakistan: Financial Sector Assessment 1990–2002*, are highly recommended, the first of which is extremely critical of the reforms that have taken place.

Appendix 15.1

Financial Sector Reforms, 1990–2000

Area of Reform	Date of Reform	Reform description
Privatization		
Amendment in the banks (Nationalization) Act 1974	1990	The Act was amended to pave the way for privatization of the nationalized commercial banks (NCBs).
Privatization of NCBs	April 1991	On 2 April 1991, 26 per cent shares of MCB were disinvested to the private sector. Another 49 per cent shares were disinvested in two steps in February 1992 and January 1993.
	Sept. 1991	On 9 September 1991, 26 per cent shares of ABL were sold to the private sector. In August 1993, a further 25 per cent of its shares were sold to the private sector.
Opening of new banks	Aug. 1991	Permission was granted to open 10 private domestic banks and licenses were granted to 3 foreign banks to operate in Pakistan. In later years, further 8 domestic and 3 foreign banks were established.
Scheduling of provincial banks	Sept. 1994	Two provincial banks namely Bank of Punjab and Bank of Khyber were scheduled.
Institutional Strengthening		
Expansion in supervisory jurisdiction of SBP	Jan. 1992	The government extended supervisory jurisdiction of the SBP to the NBFIs including leasing companies, investment banks, and housing finance companies, etc.
Issuance of prudential regulations for banks	Jan. 1992	SBP issued prudential regulations for banks. These regulations covered various aspects of operations of commercial banks and became mandatory wef 1 July 1992.
Amendment in Banking Companies Ordinance, 1962	Feb. 1993	Section 27B was inserted to curtail disruptive union activities, and section 83A was inserted to make punishable dishonest removal or disposal of goods pledged as security for payment of debt or loan. Amendments also empowered SBP to frame guidelines for facilitating recovery of bad and doubtful loans.
Grant of autonomy to the SBP	Feb. 1994	State Bank was granted autonomy in February 1994. Issuance of three more ordinances on 21 January 1997, which were approved by the Parliament in May 1997, further strengthened this autonomy.
Credit ratings for NBFIs & banks	April 1995 June 2000	Effective 20 April 1995, all NBFIs were required to have themselves credit rated by a SBP approved rating agency. The same became applicable for all commercial banks from June 2000.
Basel Accord	Dec. 1997	Banks were instructed to apply the system of risk-weighted capital, in line with the Basel Accord. From 31 December 1997, all banks were required to maintain capital and unencumbered general reserves of not less than 8% of their risk-weighted assets.
Minimum paid-up capital		Effective 31 December 1997, no banking company in Pakistan would carry on business unless it has a minimum paid-up capital of Rs. 500 million. This minimum paid up requirement for banks was doubled in December 2000 to Rs. 1,000 million with half of the increase, i.e. upto Rs. 750 million to be achieved by December 2002.
CAMELS framework		CAMELS framework was adopted to ascertain the performance of banks and NBFIs on the basis of off-site and on-site surveillance.
BASEL core principles		Out of twenty-five core principles, SBP is compliant in fourteen, largely compliant in eight, and materially non-compliant in three of these principles.
Equity support to UBL and HBL	May 1998	In terms of its bail-out package, the State Bank made equity support to UBL amounting to Rs. 21 billion on 4 May 1998 and Rs. 9.7 billion to HBL on 27 June 1998.

Appendix 15.1 (contd.)

Area of Reform	Date of Reform	Reform description
Downsizing and restructuring of banks and DFIs	1997–98	Public sector banks and DFIs were asked to prepare action plans for restructuring and downsizing of their organizations in order to reduce the financial intermediation cost. Accordingly, through various incentive schemes from 1997 to 1999, work force of these institutions was reduced from 99,954 to 81,079, while 815 loss-making branches were closed.
Establishment of Corporate & Industrial Restructuring Corporation (CIRC)	Sept. 2000	The CIRC was established on 22 September 2000 to promote revitalization of the economy by reviving sick industrial units. It will take over the NPLs of NCBs and DFIs.
Non-Performing Loans (NPLs)		
Classification of loans	Aug. 1992	Directives were issued to banks for provisioning and classification of NPLs. Loans were to be classified as other assets especially mentioned (OAEM), substandard, doubtful or loss, depending on whether interest or principal is overdue. Provisioning against substandard, doubtful and loss loan categories were required to be made at the rate of 20%, 50% and 100% respectively.
Setting of loans recovery targets	Nov. 1993	Banks were directed to lay down quarterly recovery targets as percentage of the overdue obligation. They were also required to submit progress reports on recovery in relation to targets set on quarterly basis.
New loan recovery law	Feb. 1997	In order to provide necessary legal framework to expedite the recovery of stuck-up loans, two existing recovery laws, i.e. Banking Tribunal Ordinance, 1994 and Banking Companies (Recovery of Loans) Ordinance, 1997 were repealed and replaced with a new comprehensive law—Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997.
Establishment of banking courts	Feb. 1997	The Federal Government established 34 banking courts to admit cases of loan defaults below Rs. 30 million. For cases above Rs. 30 million, two judges from Lahore High Court and one judge each from Sindh and Balochistan High Courts were nominated to deal exclusively with such cases.
Incentive schemes for loan defaulters	June 1997 Dec. 1997	SBP introduced two separate incentive schemes to provide opportunity to loan defaulters to pay their overdue loans and to reschedule and regularize the remaining amounts.
Debt Management Reforms		
Setting up of Securities Department at SBP	Dec. 1990	A Securities Department was set up in the SBP to launch an auction system of public debt and to develop a secondary market for government securities. In July 1998, the Foreign Exchange Dealing Room was setup. These two were merged and became the Exchange & Debt Management Department (EDMD) on 17 February 2000.
Auction system of Treasury Bills	March 1991	Realizing the disadvantages of the tap system and in order to develop an active money market, the government decided to introduce six-month Treasury Bills to be sold through auctions.
National Savings Scheme (NSS)	Feb. 1990	Unfunded debt instruments like the *Khas* Deposit Certificates (KDCs) were replaced with three new instruments, which offered lower but still quite attractive rates of return.
Introducing of long-term government paper	March 1991	To cater for the need of a long-term market-based government paper, Federal Investment Bonds (FIBs) were introduced with 3, 5, and 10 years maturities.
Rationalization of NSS	May 1999	Rates on these schemes were cut down to reduce distortions in term structure of interest rates.

Appendix 15.1 (contd.)

Area of Reform	Date of Reform	Reform description
Bearer instruments	Dec. 1999	From the mid 1980s till December 2000, Government issued various bearer instruments such as FEBCs, SNFBs, BNFBs, and DBCs, etc. with the aim to raise finance from the informal sector. However, the sale of these bearer instruments was discontinued in December 1999.
Monetary Management Measures		
Statuary Cash Reserve Requirement (CRR)	Oct. 1991	Under section 36(1) of SBP Act, 1956, all scheduled banks in Pakistan were required to maintain a balance–return free–with SBP equivalent to 5% of their demand and time liabilities. Throughout the reform period CRR remained more or less constant at 5%.
Averaging Mechanism of CRR		Effective from 26 July 1997, banks were advised to maintain with SBP an average balance of 5% of its total time and demand liabilities in Pakistan, worked out on weekly basis, provided that the amount of the balance should not at the close of business on any day be less than 4% of the total demand and time liabilities in Pakistan.
Special Cash Deposits (SDC)	Oct. 1991	SCD as an instrument of monetary policy was introduced on 9 October 1991 when banks were asked to maintain 7% of their outstanding credit in addition to CRR. Unlike CRR, deposits under SCD are remunerated at certain percentage. This requirement was dropped from 15 January 1992. Effective from 9 February 1995, banks were directed to maintain a SCd of 1.5 per cent of their demand and time liabilities. This requirement was further enhanced to 3.5 per cent from 11 December 1995. Effective from 1 July 1996, it was decided to dispense with this requirements.
Statuary Liquidity Requirement (SLR) for NBFIs	Jan. 1992	Effective from 1 January 1992, all NBFIs had to maintain SLR @ 15 per cent (varying from time to time).
Discount window replaced with 3-Day Repo Facility	Feb. 1992	After the introduction of a 3-Day Repo facility from 1 February 1992, it was felt prudent to close the discount window from 15 February 1992.
System of credit ceiling replaced by credit deposit ratio (CDR)	Aug. 1992	System of credit ceilings was abolished from 1 August 1992 and replaced by a relatively flexible control through the fixing of CDR in each quarter. System of CDR was also abolished on 30 September 1995 and replaced by a market-based mechanism.
Statutory Liquidity Requirement (SLR) for Banks	Oct. 1993	This required the commercial banks to maintain a minimum amount under section 29 of BCO, 1962, mainly in terms of eligible government papers in a certain ratio of their demand and time liabilities. As a part of liberalization of the financial system, this ratio was gradually reduced from 45% to 35% in October 1993 and to 25% in May 1994. The ratio was further reduced to 20% in May 1997, to 18% in January 1998 and further to 15% in June 1998.
Introduction of Open Market Operations (OMOs)	Jan. 1995	To exercise an effective indirect monetary policy, OMOs were introduced and now these constitue a major instrument of monetary policy.
Removal of caps on maximum lending rates	March 1995	As a major step towards market-based monetary management, caps on maximum lending rates of banks and NBFIs for trade related modes of financing were removed.
		In October 1995 ceilings on lending rates for project financing were also removed.
Cash Reserve Requirement (CRR) for NBFIs	Jan. 1996	All NBFIs were required to maintain 1 per cent CRR in addition to the 15 per cent SLR.
Removal of caps on minimum lending rates	July 1997	Caps on minimum lending rates of banks and NBFIs for trade and project related modes of financing were removed.
Rationalization of subsidized credit	1990–2000	Lending rates on special financing schemes including locally manufactured machinery and export finance schemes were gradually raised to eliminate the element of subsidy.

Appendix 15.1 (contd.)

Area of Reform	Date of Reform	Reform description
Master Repo	Nov. 1999	With a view to bring about operational improvements in the money market transactions, strengthening the repurchase market and ensuring transparency, the banks & NBFIs would enter into a Master Repo agreement before entering into a repo transaction.
Exchange and Payment Reforms		
Permission to open foreign currency accounts (FCAs) to resident Pakistanis	Jan. 1991	A comprehensive package of exchange and payments reforms was announced. Resident Pakistanis were allowed to hold FCAs with banks in Pakistan on the same basis as non-residents. Later in April, Charitable Trusts, Foundations, etc. were also allowed to open FCAs in Pakistan.
Remittance of profit by foreign companies	Feb. 1991	Authorized dealers designated by foreign companies were allowed to remit profits without specific SBP approval. Later in Feb. 1992, the government also abolished ceiling on payment of royalty and technical fee to non-residents.
Current account made convertible	July 1994	Pak Rupee made convertible wef 1 July 1994 by accepting obligations of Article VIII, sections 2,3 and 4 of IMF Article of Agreement.
Market-based exchange rate system	May 1999	Effective 22 July 1998, a dual exchange rate system was adopted. On 19 May 1999, this was replaced by a market-based exchange rate system given a narrow band. The unofficial cap on the exchange rate was finally removed on 21 July 2000 to make it pure market-based.
Creation of Pakistan Credit Rating Agency (PACRA) and DCR-VIS Credit Rating Company Limited	Aug. 1994	Pakistan Credit Rating Agency Limited (PACRA) was set up in 1994, by IFC in collaboration with Fitch-IBCA Inc., of UK and LSe while DCR-VIS Credit Rating Co. Ltd. was set up in 1997 in association with Duff and Phelps Credit Rating Co to improve transparency in the stock market.
Creation of Central Depository Company (CDC)	Sept. 1997	To facilitate electronic transfer of stocks, Central Depository Company of Pakistan Limited was set up in collaboration with IFC, Citibank, other leading commercial banks and DFIs. It commenced its operations in Sept. 1997.
Establishment of Securities & Exchange Commission of Pakistan (SECP)	Jan. 1999	SECP became operation from 1 January 1999 through SECP Act, 1997, replacing Corporate Law Authority (CLA).

Source: State Bank of Pakistan, *Pakistan: Financial Sector Assessment 1990–2000* (Karachi: SBP, 2002), 147–152.

Appendix 15.2

The Money Market in Pakistan

This excerpt introduces the money market in Pakistan.

The money market in Pakistan can be divided into two broad segments. Firstly, there is the call money market where the banks lend cash to each other for very short periods of time. Secondly, there is the market in which the credit ceiling is traded. This is a peculiar feature of the Pakistani money market, and any explanation of it must be preceded by an understanding of credit ceilings and their implications.

Overnight Funds

The call market is basically an overnight market though seven-day call money trades are also conducted. Fund managers faced with a shortage, or surplus, of cash can borrow, or lend, at a market rate of return. Call money is literally 'on call'. This means that, technically, a lending institution can terminate a contract at any time and 'call' its money back. The debtor bank would be obliged to comply immediately with such a request. The operative word here is 'technically' since generally no institution would withdraw from a lending agreement on ethical grounds. There would also be a cost involved in such a move.

The price of funds is set by market demand and supply. For example, if there is a dearth of money in the market, that is, the majority of financial institutions need funds, then lenders can get a high rate of interest on any loanable funds that they may have; of course, if most institutions have excess liquidity, then call money rates would fall. The major source of call market funds are the NCBs [nationalized commercial banks]. Excess liquidity created by a vast deposit base leads them to place substantial sums of money on the short term market very profitably. The major borrowers are the foreign commercial banks. There are two reasons for this. First, they have a small deposit base and must fund their everyday activities in some manner, and, secondly, the call market is a cheap source of funds for them. Surrounded by SBP regulations, the foreign banks borrow short on the call market and lend long, keeping a spread for themselves. They continuously roll over their short money to finance their long term assets. Call money transactions are normally conducted directly between banks, though, sometimes, intermediaries such as brokers are used. Settlement of trades is done in the following manner: Interest payments are made every month end, while principal is paid at the end of the specified period contained in the call agreement. For example, if bank A lends 48-hour money to bank B, then B will repay the principal after 48 hours, and the interest incurred will be settled at the end of the month. It can happen, however, that bank A does not call in its loan after 48 hours but, by mutual consent, allows B to retain the funds under the existing terms. B will of course be liable to render the additional interest accrued.

The SBP has a certain indirect regulatory role in the call market. It does this by restricting the number of players. The only non-bank to participate in the market was NDLC [National Development Leasing Company]. Although IDBP, PICIC, and BEL are DFIs, they are not allowed to play the call market. This way, SBP keeps the amount of short term funds floating around to a manageable level. There are also reserve requirements and credit ceilings imposed upon the NCBs and other foreign banks, while the majority of the DFIs have no such restrictions. Hence, indirectly, the DFIs such as NDFC and NIT play quite an important role in providing much needed short term liquidity to the banking sector.

Trading in Credit Ceiling

The second segment of the money market is that of trading in credit ceiling. The raison d'être of trading in credit ceiling is the direct ceiling controls enforced by the SBP on the banking sector. . . .

. . . In order to ensure that the aggregate credit expansion by commercial banks does not exceed the overall limit determined in the credit plan, the SBP allocates the private sector projections between all commercial banks in the form of individual ceilings. The ceiling for each bank is calculated by a formula based on the bank's share of total deposits in the system in the previous year, size of the capital fund, foreign currency deposits, and the previous year's utilization. To promote the flow of credit to priority sectors, SBP sets mandatory targets for the commercial banks in respect of loans to agriculture, business and industry, low cost housing, and fixed investment. Should any bank fail to reach the targets set for it, it becomes liable to penalty in the form of an interest free deposit with SBP to the extent of the shortfall. . . .

. . . Ceiling trading takes place when banks market their under or over-utilization of ceilings amongst themselves. At the end of the week, a bank may find that it has not utilized its full credit ceiling. SBP allows it to then sell that under-utilized amount to a bank which may have over-extended its credit limit. Trades are normally conducted on Thursday when each bank must submit its weekly report to the SBP. Each bank keeps a daily check on its credit disbursements, and, barring any unforeseen withdrawals or infusions of funds, can safely forecast its closing position. Consequently, a bank reasonably secure in the knowledge that it will not exceed its credit limit can conclude forward deals well before the end of the week. Bids and offers are made on the basis of the credit situation that week, and the rates charged depend upon demand and supply. Just as in the call market, tight credit will result in higher interest rates charged on loans, while ready availability of funds implies the opposite. Ceiling trading agreements are usually for anywhere from 15 to 90 days. As a result, the rates prevailing in the market will obviously be higher than those for call money. (One way to look at it is that call money rates are the bottom line, and money market rates will never fall below call money rates). Just like the call market, funds are exchanged between banks by means of a promissory note. Similarly, settlement is also in two parts. Interest is paid monthly, and the principal is settled at the end of the contractual term through cheques drawn on the SBP. Hence, settlement is basically an accounting procedure for the State Bank. . . .

Other Short-Term Financing (Repo Market)

Call money and ceiling trading are then the two main components of the Pakistan money market. There are, however, certain other short-term financing methods that fall somewhere between these two, but are still, none the less, within the confines of the money market. The majority of DFIs are not allowed to participate in the call market but they do, however, play in the ceiling trading market. Since ceilings are not imposed on them, DFIs, like NDFC, are in a position to assist scheduled banks in meeting their ceiling requirements. What happens is that the DFI lends to the scheduled bank's customers against the scheduled bank's guarantee. In effect, the DFI takes on to its book for a certain period of time, assets belonging to the scheduled bank and charges a commission for the service. In this way, the bank records the transaction as an off balance sheet item and its credit ceiling requirements remain undisturbed. Shortly after the introduction of the system for auctioning public debt, on 26 February 1991, SBP decided that the scheduled banks may only hold 15 per cent of their 30 per cent liquid asset requirement in the form of government issued Federal Investment Bonds and Government of Pakistan Loans. Since both these securities offered very attractive rates of return, banks were understandably disappointed. One way of getting around this restriction presented itself in the form of Repo transactions. Say, for example, that Bank A bought more FIBs than it ought to have. However, it cannot show on its books any holdings of securities in excess of the prescribed 15 per cent for fear of being penalized by the SBP. It can avoid such a penalty by engaging in a Repo transaction with a DFI (say NDFC) for the excess amount. This would be a Sale and Repurchase Agreement (SRA) whereby the bank would sell the FIBs to the DFI and then buy them back after the contractually agreed period of time. The interest component would be built into the agreement. It is important to note that during the repo transaction the DFI does not actually own the FIBs and has no right to sell them. It is, in fact, taking the FIBs onto its books and holding them in safe keeping and charging a fee for this service. The bank meanwhile has a clear slate, avoiding SBP penalties as well as earning the interest accrued on these securities.

Source: Mahmood, Javed, 'Money Markets in Pakistan: Concepts, Instruments and Operations', *Journal of the Institute of Bankers, Pakistan*, vol. 58, no. 1, 1992, 27–32.

Appendix 15.3

Changes in Monetary Management in the 1990s

Ihtasham-ul-Haque writes about some of the changes that have been undertaken by the government under agreements with the IMF and the World Bank.

The State Bank of Pakistan will no longer introduce new concessional lending schemes, and the rates of return will be liberalized, according to the latest Policy Framework Paper (PFP) of the Federal Government.

The latest PFP has been prepared by the high government authorities in collaboration with the World Bank and the IMF, elaborating various new measures to be taken during 1994–5, 1995–6 and 1996–7.

It has been decided that the State Bank's lending rate to specialized financial institutions will be reviewed in order to reduce concessional elements of such lending. All necessary steps will be taken to reduce concessional schemes and mandatory credit. The State Bank has already eliminated mandatory credit target for tobacco marketing; the share of mandatory credit in total credit will be reduced, consistent with the objective of decreasing the concentration of credit. In this regard, the target for small business and industry will be eliminated in 1995–96.

The rates on concessional credits were increased from 8 per cent in August 1993 to 13 per cent in November 1994. But now the decision has been taken, and the World Bank and the IMF assured, that there would not be any new concessional lending schemes to be introduced.

The issue was reportedly discussed thoroughly in the light of the donors' pressure, about which the President and the Prime Minister also held detailed consultations and gave the go-ahead signal for the new programme keeping in view the position of the economy.

The decision might spark criticism by businessmen but officials said that the government had no option but to close down the chapter of concessional lending schemes introduced by the State Bank from time to time in the past.

Liquidity Ratio

The financial sector reform agenda of the updated Policy Framework Paper provides for strengthening prudential regulation and supervision. Efforts will focus on greater implementation and expansion of the prudential guidelines introduced in August 1992 and on harmonization of conditions facing market participants with regard to permissible activities and capital adequacy with a view to reaching international standards.

In addition, the level and appropriateness of the liquidity ratio will be reviewed with the objectives of turning it fully into a prudential regulation. Steps will also be taken to improve the legal environment for loan recovery, minimize differential taxation of financial instruments and institutions, and enhance the prudential regulations of securities and insurance markets through institution-building.

The government has held out the assurance through the PFP that financial sector reforms would continue to be at the forefront of the policy programme and will be facilitated by the gains already achieved in the fiscal reform area.

The State Bank will continue to implement policies for the consolidation of the credit market, rationalization of the rate structure, reduction in impediments to a fully market-based allocation of credit, and completion of the move towards indirect methods of monetary control. Progress towards indirect monetary control will be pursued by increasing the credit-deposit ratio and integration of the Treasury Bill auctions into the SBP's open market operations. Specifically, the credit-deposit ratio will be increased in quarterly steps with a view to phasing it out completely by 1995-96.

The decision has also been taken to strengthen operational modalities of the open market operations through better coordination between the Ministry of Finance and the State Bank so that auction volumes for determining the basis of monetary policy considerations could be worked out.

Moreover, the government will take steps to enlarge and deepen the market for government securities with a view to enhancing the transmission mechanism of the monetary policy.

About foreign exchange and trade system reform, PFP says that the medium-term adjustment and reform programme will include further liberalization of the trade regime. Concurrently, with the tariff reform, this will be pursued in four areas between 1994-95 and 1996-97. First, the government will review and consolidate the existing Statutory Regulation Orders (SROs) with a view to reducing exemptions from customs tariffs and rate dispersion of imports subject to exemptions under SROs will be reduced in two steps and exemptions will be limited to essential items (basic foodstuffs, medicines, fertilizer, and pesticides) by 1996-97 with the exception of existing contractual obligations and for exemption with the tariff band for a limited number of industries which need time for adjustment.

No Concessional Schemes

There will be no addition to the concessional schemes approved already nor any extension in their time frame. The time frame for eligibility will not go beyond June 1997 and the concessions will not be for more than five years. In this context, the existing deletion programme will be time-bound without prolongation and no new deletion schemes will be introduced. The reduction in the scope for SROs as well as streamlining of the procedures for introducing new SROs related to the tariff and tax concessions will be undertaken.

Second, the government will review customs valuation procedures based on the Import Trade Prices (Valuation manual) with a view to moving towards an invoice-based system in accordance with GATT norms over a five-year period; barriers to imports will be liberalized further in 1995-96 by eliminating the procedural limits. Third, after the removal of a number of textile items in the context of agreement with key trading partners, the Negative List will be reduced further in 1995-96 by eliminating items unrelated to health, safety, religious, and security reasons. Fourth, the export regime will be further liberalized through the reduction in the number of items subject to export quotas, the elimination of the export development cess, and the progressive reduction in the number of export bans.

Also the government will continue to manage Pakistan's exchange rate flexibility, with a view to maintaining the external competitiveness of Pakistan's tradable goods sector consistent while containing inflationary pressures. The introduction of an upper limit on reverse money will facilitate striking a more appropriate balance between these two objectives. The government will keep under review the operation and transparency of the exchange system and will discuss this issue further with the IMF during the next review under the ESAF and EFF arrangements.

The SBP has withdrawn from forward foreign exchange cover operation on the trade account and private banks have taken up this business. In this regard, the State Bank has also increased the limit on commercial banks' foreign exchange holdings to facilitate their forward operations. As regards the forward cover fee for foreign currency accounts, the SBP recently increased it again from 4½ per cent to 4¾ per cent. The SBP intends to continue to review the scheme in view of the BOP development and changes in national and international rates of return. The Bank's withdrawal from the scheme, which is the ultimate objective, will depend on the speed of adjustment of the private market for forward exchange coverage and balance of payments developments.

Source: *DAWN*, Economic and Business Review, 21-7 January 1995.

Appendix 15.4

Theories of Inflation

Two different publications look at what causes inflation in Pakistan.

Earlier theories on inflation relied heavily on cost-push and demand-pull factors as the key components in explaining the behaviour of prices. However, in recent years, particularly during the decades of the seventies and eighties, when acceleration of high inflation was observed, three other competing models became popular in the literature in interpreting inflation, namely: a) Monetarist Inflation Model; b) Phillips Curve Model; and c) Structural Model of Inflation.

The monetarist model developed by Milton Friedman and empirically tested by Anna Schwartz simply asserted that the prime factor explaining the current rate of secular price change is the past behaviour of money to output ratio. This is also the dictum of the popular 'Quantity Theory of Money' which, in Friedman's words, purports that 'inflation everywhere is a monetary phenomenon'.

On the other hand, the Phillips curve model, which started as an empirical investigation by A. W. Phillips and was subsequently formalized by Richard Lipsey, simply postulated

that there exists a trade-off between price inflation and unemployment in the economy, at least in the short to medium run. In other words, an economy cannot simultaneously achieve lower inflation and unemployment rates.

Paul Streeten, Julio Olivera, William Baumol and Geoffrey Maynard, and Willy van Rijckeghem promoted a 'structural' approach to model inflation. Essentially, these authors argued that it is the differential rates in productivity growth, wages and elasticities of income and prices between the industrial and services sectors that determine the long-run trend of rising prices.

Although the above three theories made important contributions in understanding the underlying behaviour of inflation, these models were, nevertheless, inadequate in explaining the complex dynamic phenomenon of rising inflation particularly for third world countries. This is due to the fact that many of the underlying assumptions in the above models may not hold for those economies. For instance, the instantaneously market (money and labour) clearing assumptions made in developing 'monetarist' and 'Phillips curve' models may be too restrictive for third world economies because of the existence of structural rigidities and a large sparsely distributed monetized sector. Furthermore, because of surplus labour, particularly in the agricultural sector, the so called 'trade-off' between inflation and unemployment may not be pronounced. Therefore, in developing economies, neither rapid monetary growth nor persistence of high unemployment independently is sufficient to explain the phenomenon of chronic high inflation.

In addition, it has also been argued that third world economies with rapidly growing manufacturing sectors when encountered with supply rigidities, especially from the agriculture sector, can produce an incessant rise in relative prices in the absence of corresponding matching increases in agricultural products. Such sectoral increases in relative prices due to ensuing 'structural rigidities' may easily be translated into a rising general price level thus producing high inflation.

Criticizing the existing theories of inflation in third world economies which attempt to explain the aggregate 'general price level' in terms of other broad macro economic monetary and demand and supply factors, Sukhamoy Chakravarty et al. noted:

> Efforts have been thwarted so far by undue reliance on analysis at the aggregate levels. It must . . . be recognized that price increases cannot be readily attributed to factors, influencing only supply, or only demand. Empirical investigation of the issues . . . therefore, [is] not easy at the aggregate level. At a disaggregated (micro) level there is perhaps more room for agreement as to policy actions.

In order to comprehend the factors explaining the behaviour of prices in third world countries it is, therefore, imperative to construct a framework which should not only be a hybrid of the above theories of inflation but, more importantly, the analysis must be undertaken at much disaggregated sectoral level.

Source: Pasha, Hafiz, et al. 'What Explains the Current High Rate of Inflation in Pakistan?', *Pakistan Development Review*, Vol. 34, No. 4, 1995, 930–1.

Economic Policies and Inflation

Macroeconomic policies play a critical role in determining the rate of inflation. For example, growth of the money supply in excess of the increase in real output results in an increase in the price level in order to clear the goods market. Similarly, lax fiscal policy contributes to demand pressure, thereby fuelling inflation. Finally, exchange rate depreciation, by inducing a shift in expenditure away from internationally traded goods that become more expensive relative to non-traded goods, increases demand for domestic goods and factors of production. This, too, can have a significant impact on inflation.

Of course, monetary, fiscal, and exchange rate policies are interrelated. An expansionary fiscal stance, if financed through government borrowing from the banking system, will be reflected in an acceleration in the domestic credit and monetary aggregates. Moreover, lax monetary and fiscal policies fuel demand, part of which will be reflected in increased imports. Unless met with exchange rate depreciation, such polices can lead to lead to balance of payments (foreign exchange) difficulties.

Recent monetary developments suggest that there is a close relationship between key monetary aggregates and non-food price inflation. While overall monetary assets growth fluctuated, movements in domestic credit were considerably more pronounced. Following a decline in 1993/94, domestic credit growth picked up sharply in late 1994 and continued to rise throughout 1995 and early 1996. Much of the acceleration in credit was accounted for by the increase in government borrowing for budgetary support. In other words, fiscal policy had a strong impact on credit expansion.

Reflecting developments in the credit aggregate, non-food inflation moderated in 1994 but picked up in 1995 and early 1996. Since lax fiscal discipline accounted for much of the pick up in credit growth, the acceleration of non-food prices can be attributed to fiscal policy. Moreover, the tightening of credit policy in 1993/94 took far longer to impact inflation than the subsequent expansion in domestic credit growth, lending support to the view that inflation is considerably easier to spark than to stamp out.

As regards exchange rate policy, changes in the rate of depreciation of Pakistan's nominal effective exchange rate (NEER), a trade-weighted basket of currencies, were closely linked to movements in non-food price inflation during the 1993/94 and 1994/95 fiscal years.

Since mid 1995, however, movements in the two variables have diverged. The pace of depreciation slowed while non-food prices accelerated. Although the devaluation of the rupee in October temporarily restored the link between the two variables, the pace of depreciation of the rupee in nominal effective terms has since slowed, mainly on account of the strength of the dollar against other major currencies. Over the same period, non-food prices have continued to accelerate.

Other Determinants of Inflation

Aside from macroeconomic policies, several other factors can potentially impact the overall price level in the economy. These include supply shocks, such as sharp swings in agricultural production; adjustments in government-administered prices; movements in international prices; and the cyclical position of the economy.

Of these factors, fluctuations in agricultural output appear to be the most important determinant of overall inflation. The acceleration of prices in 1994/95 followed two consecutive years of sluggish agricultural sector performance, and the moderation in inflation starting in late 1995 came after a strong recovery in agricultural output.

However, this correlation is due entirely to the large weight of food prices in the overall consumption basket. Indeed, the observed correlation between non-food prices and agricultural sector performance in recent years suggests that the impact of such supply shocks was limited to food prices. For example, non-food prices decelerated in 1994/95, despite weak agricultural output, and accelerated in 1995/96 when agricultural production rebounded.

The impact of adjustments in government-administered prices on overall inflation is difficult to interpret from the data. To a large extent, such adjustments are unavoidable because, in the absence of the adjustments, the subsidy associated with the prevailing administered prices would give rise to an unsustainable financial imbalance for the Government.

Hence correlations between overall and administered price inflation can potentially be associated with a common underlying cause—the stance of macroeconomic policies. Lax financial discipline, for example, intensifies demand pressure and raises inflation. At the same time, inflation magnifies the extent to which administered prices diverge from their true market levels, necessitating the need for adjustments in the prices of administered goods.

In Pakistan, aside from some food items, most of the goods for which prices are administered by the Government are in the fuel and transport categories of the consumption basket. A comparison of changes in the fuel and transport sub-indices of the CPI with other non-food goods sheds light on the relation between administered-price and overall inflation. While movements in prices of administered goods have been reflected in changes in overall non-food inflation in recent years, prices of non-food items other than fuel and transport have also moved in line with overall non-food inflation. Hence, even if administered price adjustments entirely account for changes in fuel and transport prices, the deceleration of other non-food prices in 1993/94 and the subsequent acceleration is still left unexplained.

Movements in world market prices, unless offset by exchange rate changes, can also impact the domestic price level. In Pakistan, however, movements in international prices have generally not been related to changes in non-food price inflation in recent years. Throughout 1994, for example, import unit values accelerated sharply in dollar terms at a time when non-food inflation was declining. After remaining at a high level for the first half of 1995, the increase in import unit values moderated during late 1995, just as non-food prices started to accelerate.

Finally, the cyclical position of the economy can affect inflation. If, for example, growth is in excess of the economy's potential, factors of production would have to be utilized intensively, putting pressure on wages and prices. The recent acceleration in non-food prices in Pakistan, however, appears not to be related to cyclical factors. After three years of growth well below the economy's long-run trend level of 6–6.5 per cent, present rates of employment and capacity utilization are likely to be well below those consistent with full-employment.

Source: ABN AMRO, *Economic Bulletin: Inflation*, Vol. 2, No. 4, Karachi, 1996.

Appendix 15.5

What Determines Savings?

Here are fourteen factors that are supposed to affect savings.

Income Variable

Following both the Keynesian approach and the permanent income hypothesis it is hypothesised that the savings rate is positively related to the growth in national income because more surplus income means a higher savings rate in the economy. The GDP growth rate and per capita income are used alternatively as income variables in all the savings functions.

Domestic Real Interest Rate

The impact of the domestic real interest rate on domestic savings is a controversial issue among economists. On the one hand, it is argued that an increase in the real interest rate tends to encourage domestic savings through the substitution effect. On the other hand, current consumption is derived from current income through the income effect, resulting in less savings. But the empirical evidence suggests that the real interest rate is positively related with the savings rate. This study hypothesises that an increase in the real interest rate provides an incentive to the household sector to save more. With a relatively higher interest rate, the corporate sector also generates its own savings due to the higher cost of borrowing loans from domestic banking and non-banking institutions.

Domestic Credits

Bank credits to the private sector are expected to have a negative impact both on household and corporate savings. Instead of domestic bank credits to the public sector, total domestic transfers to the public sector from banking and non-banking institutions are used in the analysis, assuming a negative relationship between domestic transfers and public

savings. In fact, the availability of bank credits discourages the efforts of institutional agents to enhance their own savings.

Inflation Rate

It is assumed that the expected inflation rate has a negative impact on household and corporate savings. Because of the anticipation of a higher inflation rate in the future, people substitute their future consumption for present consumption, consequently saving less.

Foreign Interest Rate

A higher foreign interest rate may encourage people to transfer their savings abroad, thereby reducing household and corporate savings. As regards public savings, a higher interest rate on foreign debt means that the burden of debt servicing increases. Thus, foreign interest pushes the government to raise its domestic resources, resulting in increased public savings. The US prime rate is considered to be an appropriate measure of the foreign interest rate.

Export Earnings

The export sector is presumed to have an independent impact on the propensity to save and is a critical source of both private savings and government revenues. Export earnings allow the gross domestic product to rise by relieving the foreign exchange constraints, consequently increasing domestic savings. It is also argued that the export sector provides greater profits due to relatively higher prices in international markets. Therefore, the savings propensity for export earnings may be higher than in the other sectors of the economy.

Terms of Trade

Harberger, Laursen, and Metzler, postulate that savings out of any given income falls with deterioration in the terms of trade because a decline in export earnings means a fall of current income and consequently reduction in domestic savings. On the other hand, Obstfeld argues that savings may increase with deterioration in the terms of trade because the economy is forced to spend less on imported goods to maintain a target level of real wealth, thereby saving more. In this study, changes in the terms of trade are included in all the saving functions to facilitate empirical examination of these controversial arguments.

Private Capital Outflows

Private sector capital is like a migratory bird because when the weather is not favourable, it simply moves on to safer pastures. In Pakistan, nationalization measures and political unrest in the country during the 1970s and 1980s discouraged private sector economic activities, resulting in huge capital outflows from Pakistan. Moreover, capital flight resulted in a reduction of available resources to finance domestic investment, eventually leading to a decline in the rate of capital formation. This phenomenon has adversely affected the country's current and future growth and savings rates. Capital outflows hurt not only private savings but also public savings in Pakistan. Government revenue collections have declined as a result of private capital outflows, and so have, consequently, public savings.

Workers' Remittances

Workers' remittances are expected to have a positive impact on household savings because a large part of remittances are saved by the families of emigrants in Pakistan. A survey done by Gillani and Amjad revealed that 35 to 40 per cent of remittances were saved/invested by the families of emigrants in Pakistan.

Dependency Ratio

A well-known demographic variable, the dependency ratio, is also included in the household saving function. The influence of the dependency ratio on household savings in developing countries has remained a controversial issue in the literature. [A number of scholars] have found a strong negative relationship between the dependency ratio and the saving rate. Counter to this, [others] have found no significant influence of the dependency ratio on domestic savings.

Net Foreign Capital Inflows

In the economic literature, the relationship between foreign capital inflows and domestic savings has received considerable attention during the last three decades. Initially, the complementary approach was adopted. More recently, the hypothesis has been put forward that an increase in the foreign capital inflow exercises a depressing effect on domestic savings. [In our work we] focus on how the net foreign capital inflow impacts on the private sector with reference to corporate savings. The justification of not including the foreign capital inflow in the household saving function is that Pakistan is an official borrower and most of its foreign loans come through official sources. The impact of net foreign capital to the public sector is also analysed in the public saving function.

Profitability

Profit is considered as a primary determinant of private corporate savings. Therefore, a positive impact of profitability on corporate savings is expected.

Real Wage Rate

It is hypothesised that a higher bias towards labour may be detrimental to corporate savings because an increase in real wages in the large-scale manufacturing sector raises the cost of production, consequently reducing profits. Thus, a negative correlation is expected between the real wage rate and the corporate saving rate.

Debt Servicing

A negative relationship between public savings and debt servicing is expected, as every year 17 to 20 per cent of total revenues are spent on debt servicing in Pakistan, which is expected to be saved by the public sector.

Source: Iqbal, Zafar, 'Institutional Variations in Saving Behaviour in Pakistan', *Pakistan Development Review*, Vol. 32, No. 4, 1993, 1296–9.

NOTES

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Part 6

Neo-liberalism, Stabilization, and Macroeconomics: From ESAFs to PRSPs to SBAs —1988 to the present

The global processes of liberalization, privatization, and openness—broadly called 'neo-liberalism'—have also swept Pakistan into their fold, and the Structural Adjustment Programme, now implemented in over a hundred countries, has been the mechanism through which these policies are followed. The Structural Adjustment Programmes—whether in the guise of Extended Fund Facility (EFF), Enhanced Structural Adjustment Facility (ESAF), Poverty Reduction Growth Fund (PRGF) or the most recent Poverty Reduction Strategy Papers (PRSPs) and Standby Arrangements (SBAs)—enforce extensive changes in almost all sections of the economy, including issues of 'getting prices right', lower fiscal deficits, more open trade, and a freer financial sector. Despite the continued adherence of countries to Structural Adjustment Programmes, there is now extensive evidence that most countries have suffered severely due to the programmes, while many are far worse off now than they were before the programmes began. Similarly, in Pakistan, research has shown that poverty, inequality, and unemployment all increased on account of the Structural Adjustment Programmes since 1988, and low growth and high inflation became the outcome. The reasons for the Pakistani government's continued recourse to IMF/World Bank 'assistance' lie in the fact that the ruling clique is unwilling to carry out the essential and urgent reforms needed to redress critical shortcomings in the economy; they find it far easier to borrow than, for example, to cut defence expenditure markedly or carry out extensive and meaningful land reforms, or to raise taxes. The period since 1988 has changed much of the geopolitical balance around the globe. In the case of Pakistan, the post-1988 period was the worst in the country's nearly six-decade history, where there had been an unravelling of the growth of the 1980s, with poverty rising to unprecedented levels, largely on account of following the policies of the IMF and the World Bank. It was only events after 9/11 which rescued Pakistan's economy, albeit resulting in further consequences, and created a false boom, which eventually collapsed. Moreover, the Musharraf–Shaukat Aziz government became one of the most visible conduits of neo-liberalism in Pakistan, even when it was not following an IMF Programme.

16 Structural Adjustment Programmes: Composition and Effects

There is a general belief amongst many students of, and within, developing countries that the International Monetary Fund (IMF) and the World Bank, or the Washington Consensus, as their ideology is called, dominate economic policy across the world, especially in developing countries, and influence it to suit their own interests. In developing countries, politicians, academics, journalists, and numerous other concerned segments of society have come to believe that their own governments have lost all sense of autonomy and now merely follow dictation from the IMF and the World Bank. Many believe, in fact, that their own ministries of finance are now quite redundant, having been replaced by the International Ministry of Finance—see Box 16.1. Although it is true that these two agencies in Washington have exerted

Box 16.1

IMF Pressure and Conditionalities

This case from Kenya, is quite typical of the sort of influence and pressure the IMF puts on member countries. In fact, it sounds almost identical to the Pakistani case— see also Chapter 17.

Prudent economics and political virtue are not the most marked characteristics of the Kenyan government. Yet if President Daniel Arap Moi is to get the foreign aid that his drought-stricken country needs, he must convince, and keep on convincing, the IMF that his government is indeed on the path to both. At the end of July, the Fund agreed to resume lending to Kenya, but only on extraordinarily stringent conditions.

Like several other African countries, Kenya depends on two things: rain and aid. Both have dried up recently, and the country is facing the worst crisis in its history. It has not rained properly for two years and the dams are dry. In some areas people are dying from hunger, and many are permanently impoverished by the loss of their livestock. Electricity and tap water are rationed, available only for a few hours a day, and these hours, says the government, may be cut further. Many factories and businesses are at a standstill. The economy, which was once buoyant, is now growing at just 1.4%.

There has also been an aid drought. In 1997, Kenya's donors finally ran out of patience with one of the most corrupt and careless governments in Africa. The IMF abruptly stopped paying out a large loan that it had approved only a year earlier. Mr Moi has long condoned grotesque levels of looting by his top politicians and civil servants. But for many years donor countries and Kenya's government had been engaged in a complicated minuet.

The government would make extravagant promises about reforming itself. The donors and the IMF would persuade themselves that these were genuine. The aid would flow. But once the flow had started, the government would forget it promises. The money would be stolen. The donors would issue threats and then, at the last moment, the government would come up with new promises.

This time, however, things seem to have changed: the conditions for the new three-year \$198m IMF loan are the toughest ever imposed by the Fund on any government. They contain more than 60 separate elements. The loan, which will unlock a further \$300m from other donors and lenders, represents a virtual surrender of the country's sovereignty.

The IMF is insisting, for a start, that the Kenyan parliament must debate and pass a new corruption law. That, however, disguises the fact that the details of the law have already been prescribed by the Fund regardless of parliament's deliberations. Parliament must also pass a code of conduct which will rule that all public officials, except for the president himself, must declare their assets. The government will have to draw up a daily balance sheet for inspection by IMF officials. And a new team of Treasury officials will have direct financial control over other government departments.

As a reward, Kenya will receive \$18m immediately to help mitigate the effects of the drought. After that, however, the aid will be delivered in such thin slices that the slightest deviance from the programme will mean that it can be stopped instantly. There will be no leeway. Kenya is being treated too firmly not just because of its own bad record, but to show other African governments that, if they too want aid, they must rule their countries in a way the IMF approves of.

The presence of Richard Leakey, a white Kenyan palaeontologist and wildlife expert, was a critical factor in the Fund's decision to restore aid. A year ago, Mr Moi gave him the job of cleaning up the government. Speaking after the loan was approved, Mr Leakey was anxious not to be seen as the Fund's hatchet man. He insists that the conditions are a 'convergence' of policies between the IMF and the government, and that the government is committed to implementing them wholeheartedly.

Source: *The Economist*, London, 5 August 2000.

the strongest external influence on underdeveloped countries and their governments, it is important to realize that this sort of outside influence is not something new. While political pressure in its more covert forms has existed for many decades—in fact, one can argue that since the time of colonialism it has *always* existed and has never quite gone away—economic ideas and packages have been exported from Washington, at least since the formation of the World Bank and the IMF. The global dominance of the IMF was at its peak in the 1980s and 1990s, perhaps even early into the twenty-first century, but there are signs that this dominance may have waned a little in recent years. However, in countries such as Pakistan, they have played a fundamental role in the restructuring of the economy since the 1980s, and continue to have a major influence even today. Pakistan seems to be one of those few countries which continue to go back to the IMF every few years, just as it has, yet again, in September 2013.

16.1 The Development and Export of Development Thinking[1]

In the 1950s and 1960s, the model that was suggested and developed by academics and government officials in the USA focused almost entirely on growth. This model, where the general aim was to increase growth in the economies of the relatively advanced underdeveloped countries—Latin America and some Asian countries—rested on the premise that increased growth should be the fundamental focus of all policy, and eventually the fruits of growth would 'trickle down' to the population at large. The doctrine of 'functional inequality' was promoted, where the general aim of the policy was to focus on the already well-to-do and to increase their wealth, assuming that they had high saving rates and would thus reinvest their incremental wealth (see Chapter 6 for the application of this philosophy to Pakistan in the 1960s). Industrialization was the mechanism for this enhanced growth, and underdeveloped countries began to produce goods, particularly consumer and intermediate goods, which they had imported earlier—this was the import substituting industrialization phase, popular everywhere. During this phase of development, agriculture was neglected and the internal terms of trade were biased against it (again, Pakistan's experience, as shown in Chapters 6 and 8, is most revealing). Urbanization increased and the process of 'modernization' of the underdeveloped countries is said to have begun.

Soon after, the detrimental policies towards agriculture were corrected and, with the discovery of higher-yielding varieties of grain, an agricultural Green Revolution began in countries as diverse as Mexico, Pakistan, and the Philippines—often at the insistence of US officials, where the Ford Foundation and other agencies played a distinctive role.

Towards the end of the 1960s, Washington discovered that these policies of growth had caused as many problems as they had sought to solve. Economic growth had indeed taken place, but development was not assuming a particularly pleasant trend. All the countries that were being praised as high achievers in terms of growth were castigated for being poor performers on human indicators. This gave rise to other World Bank packages, such as Basic Needs and Redistribution With Growth. Growth was still important, but countries were advised to look after their poor and provide basic facilities for them as well. The 1970s also saw huge amounts of dollars being loaned to (mostly) Latin American countries, which were intended to supplement their own efforts at raising capital for investment.

After the debt crisis of the 1980s, and with deteriorating balance of payments positions and inflation in excess of 10,000 per cent in many countries, the Washington agencies stepped in again to offer programmes and loans for stabilization and structural adjustment. While Washington's view in the past may have been more advisory and suggestive, and somewhat covert in the era before the 1980s, with the Structural Adjustment Programme it became much more involved, direct, aggressive, and overt than ever before. In the 1980s, the IMF and World Bank became the driving force at the global level, and facilitated and guided economic restructuring in dozens of countries. Structural adjustment has become the leading vehicle by which the official financial institutions have gained access to policymakers and, through conditionality, have been able to induce profound changes in development policy and economic structures.

In important ways, the 1960s and 1980s have many parallels. Most important were the broad overall macroeconomic perspectives, where growth mattered most, and issues of equity and welfare were somewhat secondary. Trickle-down and functional inequality were revived under the Structural Adjustment Programmes. It came to be believed as it had been in the past, that 'economic growth, unencumbered by ancillary concerns, remains the unquestioned imperative of development strategy and that the benefits derived from economic growth can best provide the means for addressing ancillary concerns, whatever they may be'.[2] However, unlike in the 1960s, state intervention was to be minimized and protectionism became impermissible, although only for underdeveloped countries.[3] The market was the new institution that was to distribute the benefits of growth and/or development.

Strangely enough, while there are similarities between the 1960s and 1980s, the 1990s also seemed to resemble a stage in the 1970s. The incomplete success of the 1960s led to the Basic Needs approach, while in the 1990s, following the Structural Adjustment Programmes of the 1980s, concepts like social action programmes, sustainable development, adjustment with a human face, and sustainable poverty reduction were introduced to address the incomplete success of the adjustment programmes of the 1980s. History does seem to follow a strange sort of repetitive logic, albeit with significant innovations.

While Washington's economic policies have influenced, if not dominated, much of what has happened in the underdeveloped countries since most of them acquired (a misnomer) 'independence', the last few decades have seen an active and much more involved presence. For this reason, we now turn to an examination of what constitutes a stabilization and Structural Adjustment Programme, and

then examine its subsequent effects. Before that, however, it will be helpful to examine the genesis of the Structural Adjustment Programmes (see Appendix 16.1 for the theoretical underpinnings of changes in thinking about development, and Appendix 16.2 for the role of the IMF and World Bank over the last few decades).

16.2 From Structural Adjustment Loans to Structural Adjustment Programmes[4]

In the 1970s, the IMF and World Bank used to play a smaller, though important, role in the economic development of many developing countries. They used to provide loans which were based on careful country analysis and had stringent conditions attached to them. The focus of the IMF was essentially on improving the balance of payments problem, while the World Bank was more focused on specific projects and sectors. World Bank loans were usually made with projects in mind, rather than issues related to the more general workings of the macroeconomy. By the mid-1970s, commercial banks offering easy credit terms, often on few or no preconditions, replaced the IMF as the main source of credit. The rise of western banks as credit providers took place following the huge oil price rises in 1972 and 1979, when oil-rich countries deposited their petrodollars in international banks. These dollars were then recycled to developing countries, particularly to Latin American countries. The extent of this transformation was enormous: in 1971, 60 per cent of developing countries debt was owed to official lenders, while in 1981 commercial banks constituted as much as 70 per cent.

This foreign money was lent on easy terms and had a negative real rate of interest. It fuelled extensive, often luxury, consumption in most developing countries, where the élite benefited most. These developing countries had meanwhile accumulated substantial amounts of foreign debt. While interest rates were low and commercial banks were ready to lend, governments in developing countries and in the advanced countries were not very concerned about the accumulating debt. However, when US interest rates rose to 18 per cent to finance Ronald Reagan's largest peace-time military build-up, Third World countries were forced to increase their budgetary allocations to service the US dollar-denominated debt. While the cost of servicing outstanding debt increased, commercial credit to the Third World became much tighter. In a matter of a few years, commercial loans were no longer available to finance development projects, or to refinance the existing short-term debt obligations that countries had incurred.

By the early 1980s, the picture was very clear: almost without exception, developing countries were struggling to repay the debts that they had so eagerly acquired during the 1970s. At the same time, these countries had to absorb the financial losses caused by deteriorating terms of trade and high import prices for oil. In order to repay part of their debts or, more importantly, the huge interest, government spending priorities had to change. As a consequence, internal investment and social expenditures began to fall. In order to avert political unrest, many governments were compelled to maintain current spending, especially for public sector employment, at the same time as having to cut capital spending dramatically, particularly for infrastructure maintenance and improvement.

The results of such a policy were obvious at the outset: social expenditure fell in almost all those countries that had accumulated debts. The results were noticeably harsh on the poorer sections of society, who were, possibly, the main beneficiaries of public spending in the social sector. It is important to point out that defence spending suffered significantly smaller cuts than did social expenditure and investments. One reason for this was that, at least until the early and mid-1980s, many governments in the Third World were ruled by military dictators or juntas, and any cut in defence would have implied cuts in the privileges of the rulers themselves.

The IMF's initial approach to loans under the structural adjustment umbrella had two essential components. Along with the World Bank, it emphasized the stabilization of a country's macroeconomic situation by focusing on the balance of payments. Loans were meant to minimize short-term pressure on capital. There was also some insistence on measures to cut domestic aggregate demand. Demand reduction was to be undertaken by drastic cutbacks in public spending and, with the help of monetary policies, the expansion of the money supply was to be restrained. There was also a need to realign the domestic currency with international markets. It was believed that in the era of import substituting industrialization, the exchange rate was overvalued, since this made imports of machinery somewhat cheaper. Many countries also had two exchange rates—one for capital goods and the other for consumer goods. The cure for this was seen to be devaluation, after which it was believed that the country's exports would become more competitive and, since the prices of its imports would rise, the volume of imports would decline. These changes were meant to reduce the pressure on foreign reserves, hopefully improving the balance of payments position.

The second component of the policy was designed to improve overall economic efficiency and promote growth objectives by reforming macroeconomic policy and strengthening local institutions. This was the main difference between stabilization and adjustment. Stabilization, in order to deal with the contractionary repercussions of adjustment, required policy and institutional reforms on both a macroeconomic and sectoral level. The IMF continued to give priority to short-term loan support to economies where the primary focus was demand constraint measures and currency valuation. The World Bank focused on sectoral loans and on restructuring economies through institutional and policy reform in the medium term to stimulate the medium-term supply response—See Box 16.2 on information and background on the IMF.

There was a major change from the mid-1980s, when the programmes of the World Bank and IMF began to become more fused. Also, the distinction between stabilization and

Box 16.2

What is the International Monetary Fund?

The International Monetary Fund—also known as the 'IMF' or the 'Fund'—was conceived, along with the World Bank, at a United Nations conference convened in Bretton Woods, New Hampshire, U.S. in July 1944—this is why it is also known, with the World Bank, as one of the Bretton Woods Institutions (BWIs). The 45 governments represented at that conference—all from developed countries, of course, many, like Britain and France, still colonial powers—sought to build a framework for economic co-operation that would avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the 1930s. The International Monetary Fund was created in 1945 to help promote the health of the world economy. Headquartered in Washington DC, it is governed by and accountable to the governments of the 184 countries that make up its near-global membership. It has a staff of approximately 2,680 from 141 countries, with total quotas of around $300 billion, and outstanding loans against its name of $107 billion to 56 countries, of which 38 are on concessional terms. In 2003, the IMF concluded surveillance consultations with 136 countries, of which 96 voluntarily published their staff reports. The IMF's resources are provided by its member countries, primarily through payment of quotas, which broadly reflect each country's economic size. The total amount of quotas is the most important factor determining the IMF's lending capacity. The annual expenses of running the Fund are met mainly by the difference between interest receipts (on outstanding loans) and interest payments (on quota 'deposits').

Article I of the Articles of Agreement sets out the IMF's main responsibilities: promoting international monetary co-operation; facilitating the expansion and balanced growth of international trade; promoting exchange stability; assisting in the establishment of a multilateral system of payments; and making its resources available (under adequate safeguards) to members experiencing balance of payments difficulties.

IMF Activities

More generally, the IMF is responsible for ensuring the stability of the international monetary and financial system—the system of international payments and exchange rates among national currencies that enables trade to take place between countries. The Fund seeks to promote economic stability and prevent crises; to help resolve crises when they do occur; and to promote growth and alleviate poverty. It employs three main functions—surveillance, technical assistance, and lending—to meet these objectives. The IMF works to promote global growth and economic stability—and thereby prevent economic crisis—by encouraging countries to adopt sound economic policies. Surveillance is the regular dialogue and policy advice that the IMF offers to each of its members. Generally once a year, the Fund conducts in-depth appraisals of each member country's economic situation. It discusses with the country's authorities the policies that are most conducive to stable exchange rates and a growing and prosperous economy. The IMF also combines information from individual consultations to form assessments of global and regional developments and prospects. Its views are published twice each year in the World Economic Outlook and the Global Financial Stability Report. Technical assistance and training are offered—mostly free of charge—to help member countries strengthen their capacity to design and implement effective policies. Technical assistance is offered in several areas, including fiscal policy, monetary and exchange rate policies, banking and financial system supervision and regulation, and statistics. In the event that member countries do experience difficulties financing their balance of payments, the IMF is also a fund that can be tapped to help in recovery. Financial assistance is available to give member countries the breathing room they need to correct balance of payments problems. A policy programme supported by IMF financing is designed by the national authorities in close co-operation with the IMF, and continued financial support is conditional on effective implementation of this programme. The IMF is also actively working to reduce poverty in countries around the globe, independently and in collaboration with the World Bank and other organizations.

The eight countries that constitute the G-8, together control 48 per cent of IMF's voting power, with the US having 17.14 per cent of votes, Japan 6.23 per cent, Germany 6.11 per cent, France 5.05 per cent, and so on. The number of votes is determined by contributions to the IMF, with the rich and developed countries making larger contribution, and controlling greater votes to determine policy and to decide which countries will get IMF loans and under what conditions.

Source: IMF web site.

The winner of the 2001 Nobel Prize for Economics, Professor Joseph Stiglitz, has been a critic of the IMF and the way it has addressed issues across the globe. He writes:

> In its original conception, then, the IMF was based on a recognition that markets often did not work well—that they could result in massive unemployment and might fail to make needed funds available to countries to help them restore their economies. The IMF was founded on the belief that there was a need for *collective action at the global* level for economic stability, just as the United Nations had been founded on the belief that there was a need for collective action at the global level for political stability. The IMF is a *public* institution, established with money provided by taxpayers around the world. This is important to remember because it does not report directly to either the citizens who finance it or those whose lives it affects. Rather, it reports to the ministries of finance and the central banks of the governments of the world. They assert their control through a complicated voting arrangement based largely on the economic power of the countries at the end of World War II. There have been some minor adjustments since, but the major developed countries run the show, with only one country, the United States, having effective veto. (In this sense, it is similar to he UN, where a historical anachronism determines who holds the veto—the victorious powers of World War II—but at least there the veto power is shared among five countries.)

Box 16.2 (continued)

Over the years since its inception, the IMF has changed markedly. Founded on the belief that markets often worked badly, it now champions market supremacy with ideological fervour. Founded on the belief that there is a need for international pressure on countries to have more expansionary economic policies—such as increasing expenditures, reducing taxes, or lowering interest rates to stimulate the economy—today the IMF typically provides funds only if countries engage in policies like cutting deficits, raising taxes, or raising interest rates that lead to a contraction of the economy. Keynes would be rolling over in his grave were he to see what has happened to his child.

The most dramatic change in these institutions occurred in the 1980s, the era when Ronald Reagan and Margaret Thatcher preached free market ideology in the United States and the United Kingdom. The IMF and the World Bank became the new missionary institutions, through which these ideas were pushed on the reluctant poor countries that often badly needed their loans and grants. The ministries of finance in poor countries were willing to become converts, if necessary, to obtain the funds, though the vast majority of government officials, and more to the point, people in these countries often remained skeptical.

. . . A half century after its founding, it is clear that the IMF has failed in its mission. It has not done what it was supposed to do—provide funds for countries facing an economic downturn, to enable the country to restore itself to close to full employment. In spite of the fact that our understanding of economic processes has increased enormously during the last fifty years, and in spite of IMF's efforts during the past quarter century, crises around the world have been more frequent and (with the exception of the Great Depression) deeper. By some reckonings, close to a hundred countries have faced crises. Worse, many of the policies that the IMF pushed, in particular, premature capital market liberalization, have contributed to global instability. And once a country was in crisis, IMF funds and programmes not only failed to stabilize the situation but in many cases actually made matters worse, especially for the poor. The IMF failed in its original mission of promoting global stability; it has also been no more successful in the new missions that it has undertaken, such as guiding the transition of countries from communism to a market economy. . . .

. . . The ideas and intentions behind the creation of the international economic institutions were good ones, yet they gradually evolved over the years to become something very different. The Keynesian orientation of the IMF, which emphasized market failures and the role for government in job creation, was replaced by the free market mantra of the 1980s, part of a new 'Washington Consensus'—a consensus between the IMF, the World Bank and the US Treasury about the 'right' policies for developing countries—that signalled a radically different approach to economic development and stabilization. . . .

. . . The ideas that were developed to cope with problems arguably specific to Latin American counties, subsequently been deemed applicable to countries around the world. Capital market liberalization has been pushed despite the fact that there is no evidence showing it spurs economic growth. In other cases, the economic policies that evolved into the Washington Consensus and were introduced into developing countries were not appropriate for countries in the early stages of development or early stages of transition.

To take just a few examples, most of the advanced industrial countries—including the United States and Japan—have built their economies by wisely and selectively protecting some of their industries until they were strong enough to compete with foreign companies. While blanket protectionism has often not worked for countries that have tried it, neither has rapid trade liberalization. Forcing a developing country to open itself up to imported products that would compete with those produced by certain of its industries, industries that were dangerously vulnerable to competition from much stronger counterpart industries in other countries, can have disastrous consequences—socially and economically. Jobs have systematically been destroyed—poor farmers in developing countries simply couldn't compete with the highly subsidized goods from Europe and America—before the countries' industrial and agricultural sectors were able to grow strong and create new jobs. Even worse, the IMF's insistence on developing countries maintaining tight monetary policies has led to interest rates that would make job creation impossible even in the best of circumstances. And because trade liberalization occurred before safety nets were put into place, those who lost their jobs were forced into poverty. Liberalization has thus, too often, not been followed by the promised growth, but by increased misery. And even those who have not lost their jobs have been hit by a heightened sense of insecurity.

Capital controls are another example: European countries banned the free flow of capital until the seventies. Some might say it's not fair to insist that developing countries with a barely functioning bank system risk opening their markets. But putting aside such notions of fairness, it's bad economics; the influx of hot money into and out of the country that so frequently follows after capital market liberalization leaves havoc in its wake. Small developing countries are like small boats. Rapid capital market liberalization, in the manner pushed by the IMF, amounted to setting them off on a voyage on a rough sea, before the holes in their hulls have been repaired, before the captain has received training, before life vests have been put on board. Even in the best of circumstances, there was a high likelihood that they would be overturned when they were hit broadside by a big wave.

The application of mistaken economic theories would not be such a problem if the end of first colonialism and then communism had not given the IMF and the World Bank the opportunity to greatly expand their respective original mandates, to vastly extend their reach. Today these institutions have become dominant players in the world economy. Not only countries seeking their help but also those seeking their 'seal of approval' so that they can better access international capital markets' and must follow their economic prescriptions, prescriptions which reflect their free market ideologies and theories.

Box 16.2 (continued)

The result for many people has been poverty and for many countries social and political chaos. The IMF has made mistakes in all the areas it has been involved in: development, crisis management, and in countries making the transition from communism to capitalism. Structural adjustment programmes did not bring sustained growth even to those, like Bolivia, that adhered to its strictures; in many countries, excessive austerity stifled growth; successful economic programmes require extreme care in *sequencing*—the order in which reforms occur—and pacing. If, for instance, markets are opened up for competition too rapidly, before strong financial institutions are established, then jobs will be destroyed faster than new jobs are created. In many countries, mistakes in sequencing and pacing led to rising unemployment and increased poverty.

Underlying the problems of the IMF and the other international economic institutions is the problem of governance: who decides what they do. The institutions are dominated not just by the wealthiest industrial countries but by commercial and financial interests in those countries, and the policies of the institutions naturally reflect this. The choice heads for these institutions symbolizes the institutions' problem, and too often has contributed to their dysfunction. While almost all of the activities of the IMF and the World Bank today are in the developing world (certainly, all of their lending), they are led by representatives from the industrialized nations (By custom or tacit agreement the head of the IMF is always a European, that of the World Bank an American). They are chosen behind closed doors, and it has never even been viewed as a prerequisite that the head should have any experience in the developing world. The institutions are not representatives of the nations they serve.

Source: Joseph Sliglitz, *Globalization and its Discontents* (London: Allen Lane, 2002), 12–19.

adjustment became narrower, and the Structural Adjustment Programmes of the late 1980s onwards had elements of both. There were also differences in the time span of loans. Earlier, structural adjustment loans were for twelve to eighteen months, but as institutional and policy reform became an increasingly important concern, the period of the loans increased to between three and five years. Now, more complex and stringent conditions were also being attached to loans, which were much bigger in money terms than ever before. The number of conditions attached to a structural adjustment loan increased from an average of twenty-seven in 1985, to fifty-six in 1989.

Since the 1980s, dozens of countries have made use of IMF and World Bank structural adjustment loans. In the 1980s, as much as $41 billion was made available to finance 258 loans, and although Africa received almost half of those loans, it was the Latin American countries as a whole which received the largest amount in this period (see Table 16.1 for more recent information). Since the economies of Latin America are larger, they may have had recourse to fewer but much larger loans (see Box 16.3 on the IMF's finances).

Box 16.3

The IMF's Finances

Can the IMF help all the countries of the world facing an imminent economic collapse?

After committing $17.8 billion to rescue Mexico, how much money does the International Monetary Fund (IMF) have left in its coffers? The question sounds simple. But the answer is not, for the IMF's financial structure is fiendishly complex.

For a start, its internal accounts are calculated in terms of special drawing rights (SDRs)—artificial assets created by the IMF and made up of a weighted basket of the world's five top currencies. At present, one SDR is worth $1.47.

The IMF's main source of capital is the subscriptions, or quotas that all its members pay. A country's quota depends on the size of its economy. The total amount of IMF quotas is 145 billion SDRs. But since countries pay part of their quota in their own currencies, and many of these are not freely convertible, the IMF's liquid resources stand at only 62.5 billion SDRs after its efforts to help the Mexicans. As some of these liquid resources have already been committed to countries in trouble, the IMF has an adjusted measure for what it calls 'uncommitted usable resources'. These total 48 billion SDRs.

The usual way to top-up the IMF's resources is to increase members' quotas, but this takes time. So in emergencies there are other potential sources of cash. Under a special agreement, the IMF can borrow up to 17 billion SDRs from industrialized countries and another 1.5 billion SDRs from Saudi Arabia. In extremis, it could sell some of its 104m ounces of gold, which are probably worth around $39 billion.

The IMF has some liabilities too. Every one of its members is entitled to receive a portion of its quota (the so called 'reserve tranche') with no questions asked. The IMF must always be in a position to honour these tranches, which add up to around 29 billion SDRs.

The reality, then, is that it is almost impossible to calculate how much the Fund could safely lend to a troubled country. Nonetheless, Lamberto Dino, the Italian prime minister and an old IMF hand, says that its resources are not suited to dealing with the stabilizing capital flows. One thing is sure: it could not cope with many more Mexicos.

Source: *The Economist*, 11 February 1995.

Box 16.5
IMF's Lending Arrangements

IMF credit is made available under a variety of borrowing arrangements with different disbursement schedules and maturities depending on the balance of payment needs of the member.

Stand-By Arrangements: The most common type of credit arrangement designed to provide short-term financial assistance. Purchases under Stand-By Arrangements are repayable in 8 quarterly instalments 2¼–4 years after disbursement under the expectation schedule, and 3¼–5 years after disbursement under the obligation schedule.

Extended Arrangements provide credit for a longer period since these arrangements usually require fundamental reforms which may need more time to put in place and take effect. Drawings under extended arrangements are repayable in 6 semi-annual instalments, 4¼–7 years after disbursement under the expectation schedule, and in 12 semi-annual instalments 4½–10 years after disbursement under the obligation schedule.

PRGF Arrangements: Concessional arrangements providing credit at an interest rate of ½ of 1 per cent to eligible low-income members. The loans are repayable in 10 equal semi-annual instalments 5½–10 years after disbursement.

The Supplemental Reserve Facility (SRF) provides financial assistance to members experiencing exceptional balance of payments difficulties due to short-term financing needs resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the members' reserves. SRF resources are provided under Stand-By and Extended Arrangements and are repayable in 2 instalments 2–2½ years after disbursement under the expectation schedule, and 2½–3 years under the obligation schedule.

What is the Poverty Reduction and Growth Facility?

The IMF provides financial support through its concessional lending facility—the Poverty Reduction and Growth Facility (PRGF)—and through debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative. The Poverty Reduction and Growth Facility (PRGF) is the IMF's low-interest lending facility for poor countries. PRGF-supported programmes are underpinned by comprehensive country-owned poverty reduction strategies. The Poverty Reduction and Growth Facility (PRGF), was formerly known as the Enhanced Structural Adjustment Facility (ESAF), provides loans at a concessional interest rate to eligible, low-income members. PRSPs are a requirement for countries in order to receive concessional assistance from the World Band and the IMF (through the PRGF). In addition, they are the basis for the provision of debt relief under the HIPC Initiative.

In September 1999, the IMF established the Poverty Reduction and Growth Facility (PRGF) to make the objectives of poverty reduction and growth more central to lending operations in its poorest member countries. A review of the PRGF completed in 2002 confirmed that the design of the programmes supported by PRGF lending have, in fact, become more pro-poor and pro-growth. In most low-income countries, IMF support is underpinned by Poverty Reduction Strategy Papers (PRSP). These papers are prepared by country authorities—in consultation with civil society and external development partners—to describe a comprehensive economic, structural, and social policy framework that is being implemented to promote growth and reduce poverty in the country.

PRGF-supported programmes are framed around comprehensive, country-owned Poverty Reduction Strategy Papers (PRSPs). PRSPs are prepared by governments with the active participation of civil society and other development partners. PRSPs are then considered by the Executive Boards of the IMF and the World Bank as the basis for concessional lending from each institution and debt relief under the joint Heavily Indebted Poor Countries (HIPC) Initiative. The targets and policy conditions in a PRGF-supported programme are drawn directly from the country's PRSP.

As of September 2003, 77 low-income countries are eligible for PRGF assistance. Eligibility is based principally on the IMF's assessment of a country's per capita income, drawing on the cut-off point for eligibility to World Bank concessional lending (currently 2001 per capita gross national income of $875). Loans under the PRGF carry an annual interest rate of 0.5 per cent, with repayments made semi-annually, beginning five-and-a-half years and ending 10 years after the disbursement. An eligible country may normally borrow up to a maximum of 140 per cent of its IMF quota under a three-year arrangement, although this may be increased to 185 per cent of quota in exceptional circumstances. In each case, the amount will depend on the country's balance of payments need, the strength of its adjustment programme, and its previous and outstanding use of IMF credit. The expected average access under the initial three-year arrangement is 90 per cent of quota, and for second time users of the facility, 65 per cent of quota over three years.

IMF-World Bank Co-operation

PRGF-supported programmes are designed to cover only areas within the primary responsibility of the IMF, unless a particular measure is judged to have a direct, critical macroeconomic impact. Areas typically covered by the IMF include advising on prudent macroeconomic policies and related structural reforms such as exchange rate and tax policy, fiscal management, budget execution, fiscal transparency, and tax and customs administration. When appropriate, the IMF draws on World Bank expertise in designing PRGF-supported programmes, and the staffs of the Fund and Bank cooperate closely on conditionality. The Bank staff takes the lead in advising the authorities in the design of poverty reduction strategies in areas such as poverty assessments, monitoring, structural and sectoral issues, social issues, and costing priority poverty-reducing spending.

How the PRGF is Financed

Concessional lending under the PRGF is administered by the IMF through the PRGF and PRGF-HIPC Trusts. The PRGF Trust borrows resources from central banks, governments, and official institutions generally at market-related interest rates, and lends them on a pass-through basis to PRGF-eligible countries. The difference between the market-related interest rate paid to PRGF Trust lenders and the rate of interest of 0.5 per cent per year paid by the borrowing members is financed by contributions from bilateral donors and the IMF's own resources.

Latin American countries offered relief for debt that had accumulated over the 1970s. However, the US agreed to provide funds only if these countries agreed to deregulate and make major changes in their economies. The IMF conformed to the US position, and neo-liberal orthodoxy in economics became the only paradigm of any consequence. The Structural Adjustment Programmes discussed above are an important policy tool in the broader framework of economic liberalism, and thus it is important to place them in their proper context.

Even a cursory examination of what constitutes economic liberalization will show its close parallels with the Structural Adjustment Programme. For example, liberalization requires trade openness, where there is an exposure of the domestic goods market to the international economy. Financial openness requires exposure of the domestic financial system to world capital markets. Liberalization implies an outward orientation in which imports are to be liberalized and tariffs cut, devaluation of the local currency ought to take place, and production should switch from import substituting to exportable goods and commodities. A central feature of the liberal orthodoxy is a reduction in the role of the government, with minimal government restrictions and involvement in international trade in goods and asset markets, as well as in domestic financial, commodity, and labour markets. In essence, then, economic liberalization requires a policy package to take the economy away from illiberalism towards liberalism or, what is the same thing, towards *laissez-faire*, or a free-market, pro-private sector economy. The case for economic liberalization has rested upon the claim that all the above policy reforms contribute towards higher growth and reduced dependence of the economy.

The neoclassical position holds the view that financial activity is necessary not only for the mobilization and efficient allocation of resources, but also as a stabilizing force in the economy. Hence, the recommendation to deregulate and privatize the financial sector. Furthermore, this logic holds that the greater the openness of any country, the less its vulnerability to international economic fluctuations. (see Box 16.6 for a very different view.

The evidence from countries which have had more liberal and open economies shows that they have not performed as well as those which are considered closed and more controlled. For example, it has been seen, contrary to the ideology which advocates openness, that open financial markets are more vulnerable to exogenous shocks. In a comparison of India and China (closed) with Brazil and Mexico (open) there is evidence that the closed countries performed better during the world economic slowdown of the 1980s than the ones more closely integrated with the world economy.[39] India and China had long followed the path of self-reliance and import substituting industrialization and depended far less on foreign debt. Until a few years ago they were not very open to foreign interests and they were able to cope with the world economic recession precisely for this reason. By integrating with the international financial markets, most countries of Latin America suffered as their dependence for foreign funds had always been quite substantial.

The neo-liberal thinking, and that accepted by the IMF in its stabilization and Structural Adjustment Programmes, makes the strong claim that openness and trade liberalization have a positive outcome for growth. However, cross-sectional and time series evidence does not support this claim and these empirical linkages are not observed. In fact, a study by Alan Hughes and Ajit Singh suggests that the most successful countries in the 1970s and 1980s stayed far from the path of *laissez-faire* and openness.[40] However, with increased globalization and integration, it is possible that this pattern may be changing.

The Structural Adjustment Programme finds its intellectual and policy roots in economic liberalization or, in fact, in neo-liberalism. We saw earlier how the programmes have been unable to address many of the issues they have targeted, and the supposed beneficial results from liberalization have also been found to be questionable. Open economies with greater degrees of liberalization are not necessarily better performers than closed economies. In fact, if anything, closed economies seem better suited to deal with slumps and crises in the world markets as the 2008 economic crisis has shown. These observations lead to an important criticism of neoclassical thinking, economic liberalization, and especially Structural Adjustment Programmes, which is discussed in the next section.

16.5.1 The Contextuality of Policy[41]

A major criticism of economic liberalization and Structural Adjustment Programmes is that they are being offered as a complete cure for a country's ills, *regardless of the particular institutional arrangements or the historical background which may exist*. A 'general' theory and a 'general' prescription is applied unilaterally to any 'typical' developing country. What is required, however, is a deeper understanding of the *specific* historical conditions and *specific* institutional contexts of *specific* countries. Policy must take into account the historical and institutional contexts in which particular policies will operate. Neglect and misunderstanding of the particular circumstances of particular countries, and thus of which policies are most feasible, are responsible for the failure of many standard and conventional adjustment programmes that emphasize economic liberalization. The recognition of historical and institutional factors specific to a country would help us to examine more closely the special circumstances of each country and region, so that we can discover its particular strengths and weaknesses and chart a desirable direction for social change.

Whether a policy can be implemented at all, whether if implanted it will have the desired effect, and whether some policies will result in undesirable consequences may depend critically on the nature of economic institutions and the balance of political forces which exist in that country. As specific institutional arrangements and the nature of political involvement and organization are likely to differ from country to country, it is likely that an abstract generalist framework, such as that suggested by a Structural Adjustment Programme, may be less effective than a precise and country-specific policy.

Box 16.6

Hot Money and its Consequences

What happens when money is highly mobile? Some answers:

When hot money flows occur, the recipient country has two choices: either to maintain the exchange rate by adding to reserves or to prevent a swelling of reserves by letting the exchange rate appreciate. Any government wishing to prevent a gratuitous 'deindustrialization' of the economy (and hence a gratuitous 'manufacture' of a current account deficit to accommodate hot money inflows) would of course prefer to prevent an exchange rate appreciation by adding to exchange reserves. And since these enhanced reserves represent after all an additional command over resources, even hot money flows, it may be thought, can add to the pace of capital formation if properly utilized.

The problem however is two-fold: the minor problem relates to the fact that using reserves built up with hot money for undertaking investment implies in essence that the country is 'borrowing short to invest long' which exposes it to potential crises. But even if this is tackled by choosing short-gestation, foreign-exchange-earning investment projects, there remains a major problem, namely, there has to be an *agency* that must take the lead in stepping up capital formation: and an economy under Fund-Bank thraldom lacks such an agency. Since the state is increasingly forced to withdraw from its investment role it cannot step up investment directly. Since the state cannot order private investment, it can stimulate the latter only indirectly: but the obvious indirect instrument, namely, the interest rate, can scarcely be used for fear of frightening international rentiers. And portfolio investment which typically stimulates stock market booms makes speculation more attractive than productive investment for the domestic capitalists. Finally, since 'market-friendliness' takes the form *inter alia* of trade liberalization which brings in MNC products to the local market, this fact tends to dampen the inducement to invest of domestic capitalists.

The upshot is that foreign exchange reserves accumulate even as productive investment languishes. The reserve accumulation, it may be thought, would give rise to a *consumption-led boom*. But, for reasons already discussed, credit to finance such a boom is expensive. And even if it does play a role, the boom would be a brief and evanescent one, unit of domestic supply constraints begin to appear (at which point reserves would start getting used up to augment supplies and the domestic multiplier effects of higher consumption would disappear). What is even more likely, however, is that such consumption growth as occurs owing to the effects of hot money inflows would, in a 'liberalized trade' regime, leak out abroad without generating any domestic growth.

On the other hand, when hot money flows out, the very fact that the reserves have shrunk in the event of higher domestic consumption (or if the outflow is larger than the extant reserves can sustain), the economy has to be deflated, and a whole lot of measures, including handing over the country's natural resources 'for a song' to international creditors, have to be adopted, to cope with the foreign exchange crunch. The net result is a process of gradual economic atrophy together with 'denationalization' of assets and resources.

Source: Patnaik, Prabhat and C. P. Chandrasekhar, 'Indian Economy Under "Structural Adjustment"', *Economic and Political Weekly*, vol. 30, no. 47, 1995, 3009–10.

Mexico is an old hand at IMF/World Bank Structural Adjustment Programmes and began restructuring its economy under IMF guidelines from as early as 1976. The IMF and World Bank have evaluated the performance of Mexico quite favourably, for it closely followed the policy outlines, which are quite standard. There was considerable progress, as per conditions, on the trade front with imports liberalized and tariffs reduced. The real exchange rate was depreciated substantially, some state-owned enterprises were privatized, and food subsidies were removed. There was some progress in the financial sector with reductions in directed credit, in credit subsidies, and importantly, in controls on foreign direct and portfolio investment. On 20 December 1994, the bubble burst and the Mexican bond and equity market collapsed, having serious negative consequences for other Latin American and emerging markets.

The reasons why the bond and equity market collapsed in Mexico are now very clear. The government bungled a devaluation strategy which had been recommended and was necessary. The inability of the government of Mexico to uphold its promise of allowing the peso to devalue by a maximum of 13 per cent resulted in an exodus by foreign investors from the stock market. The immediate response to this exit was a knee-jerk flotation which ended up with a devaluation of more than 35 per cent. The reason for the first-announced devaluation was an attempt to come to grips with the burgeoning current account deficit, then at 8 per cent of GDP, which was believed to be due to an overvalued exchange rate.

The essential characteristics of the Mexican economy during 1994 were as follows: an overvalued peso, an overdependence on short-term flows of foreign money, and an over-expansionary monetary policy. Foreign investors held 70 per cent of Mexican peso-dominated bonds, and around 80 per cent of outstanding dollar-denominated bonds, most of which were held by short-term investors. The involvement of foreign investors in Mexico since 1990 has been substantial and they have snapped up more than $55 billion worth of Mexican shares in the last four years. Last June, the exposure of US banks in Mexico alone was $17.2 billion.

The key issue here is Mexico's vulnerability and exposure to hot money from abroad. Literally overnight, foreign portfolio investors withdrew from the Mexican markets, leaving the economy in potential ruin. The possible consequences of this move for Mexico are very high inflation, low growth due to poor domestic demand and more expensive imports, growing unemployment and poverty, and a severe lack of confidence on the part of foreign investors. Despite the neo-classical doctrine supported by the IMF/World Bank of opening one's markets to international capital, there may be some wisdom in proceeding cautiously and very carefully, rather than adhering to every demand made by Washington.

Source: Zaidi, S. Akbar, own research.

In sub-Saharan Africa, where the IMF/World Bank package of stabilization and structural adjustment has been most ambitiously imposed, the severely underdeveloped nature of property rights has caused problems in identifying and working with the 'market'.[42] The emphasis on 'getting prices right', and on letting the market determine resource allocation, may not be feasible in countries where the market is small, does not exist, or is distorted by numerous imperfections. Even the World Bank, in one of its more candid moments, 'has openly accepted the fact that the scores of conditions attached to structural adjustment loans may contribute little to the ultimate success of individual adjustment packages simply because they are too complex and *do not correspond to institutional conditions* and managerial capacities in an adjusting country'.[43] The Bank has recently realized that 'frequently, the necessary markets or other institutions are not there, or they do not work well or as expected. Failure to take into account institutional characteristics specific to the country can lead to poor advice. . . . *The blanket recommendation of generally accepted policies can be disastrous in particular circumstances*.'[44]

Economic theory and observations from across countries show that the nature of current economic, social, and political relationships is affected by the past economic history of that country and by its political and institutional arrangements. There is a 'path dependence' of economic variables and they are conditioned by their own past behaviour. The effect of government policies in macroeconomic variables is determined, somewhat, by the past behaviour of economic variables themselves, by economic policies, and by the past and ingrained behaviour of economic institutions. Governments cannot introduce successful institutional arrangements, a key factor in economic liberalization and in the Structural Adjustment Programmes, unless the social and political conditions conducive to such change exist—See Box 16.7 for how the East Asian crisis of 1997 was mishandled by the IMF.

16.5.2 International Capital and the Loss of National Autonomy

The major consequence of economic liberalization, openness, and globalization has been the extension, or incorporation, of countries into the world economy. Under closed and less liberal economic policies, the unit of analysis used to be one's own nation, where economic policies and reform within a country affected economic, political, and social arrangements domestically. This has changed dramatically with the 'opening up' of the underdeveloped countries, where events in different geographical and economic regions now affect national economic performance. Countries have become more dependent on factors to which they are not related or for which they are not responsible. The economic 'meltdown' of the Asian Tigers following the currency mayhem in June 1997 is an illustration of how financial openness and exposure to outside influences can, in one stroke, liquidate the gains made over a number of decades.

Financial openness or globalization as a factor in economic policy means that there is international substitutability of assets. When domestic financial assets are close, or perfect, substitutes for foreign financial assets, domestic policymakers can exert influence over the effective stock or price of those assets only to the extent that the domestic share is large compared to the world share. A large country that dominates financial markets has control over its own prices, and other relevant targets. For a relatively small country, as are most underdeveloped countries, control over domestic interest rates or money supply might be way off target, having serious negative consequences for real targets such as investment, growth, and inflation.[45] In the case of floating and 'free' exchange rates, weaker countries may even become more subject to the ill effects of international capital flows or the judgements of investors, despite the fact that domestic policies are sound, (see Box 16.7).

Three important strands of the international economy have become quite predominant in the economic world since the 1990s.[46] There is a huge internationalization of capital, where wealth holders of any one country are now holding, directly or indirectly, much larger financial claims upon financial assets of other countries than in the past. Secondly, the average maturity of these claims has tended to decline over time. Finally, the shortening of the maturity of these claims is matched by a tremendous mobility of capital internationally. Essentially then, there is a huge amount of 'hot' or 'near-hot' money which can move in enormous quantities from one country to another at very short notice (see Box 16.6). Conditions in one country can result in the flight of capital from another, even when the latter is doing well in economic terms. A rise in interest rates in the West can cause large sums of money to shift overnight, causing havoc in smaller, more exposed, markets. Thus, attempts to control the domestic economy can be made quite powerless due to factors well beyond a country's control. Clearly, the internationalization of capital undermines the autonomy of national economic planning. Economic liberalization and Structural Adjustment Programmes emphasize more openness and globalization of economies. Beyond doubt, there are numerous contradictions inherent in such a policy, many of which have been identified in this chapter.

16.6 Summary and Further Reading

16.6.1 Summary

In this chapter we have taken a critical look at the Structural Adjustment Programme and at the way the IMF and World Bank have evolved into the most influential organizations in the world, determining economic policy and programmes in dozens of countries across the globe. The chapter begins with a brief historical look at how economic development has evolved over the last fifty years, and at how economic policy is now determined. A detailed section on the composition of the Structural Adjustment Programme examined the different sectors and issues that such programmes address.

Since Structural Adjustment Programmes have been in operation for almost a quarter of a century, there is enough evidence to examine their consequences and implications. A vast literature does that, and the general consensus seems to

Box 16.7

The East Asian Crisis and the IMF's Response

When the Thai baht collapsed on 2 July 1997, no one knew that this was the beginning of the greatest economic crisis since the Great Depression—one that would spread from Asia to Russia and Latin America and threaten the entire world. Currency speculation spread and hit Malaysia, South Korea, the Philippines, and Indonesia, and by the end of the year what had started as an exchange rate disaster threatened to take down many of the region's banks, stock markets, and even entire economies. The crisis is over now, but countries such as Indonesia will feel its effects for years. Unfortunately, the IMF policies imposed during this tumultuous time worsened the situation. Since the IMF was founded precisely to avert and deal with crises of this kind, the fact that it failed in so many ways led to a major rethinking of its role, with many people in the United States and abroad calling for an overhaul of many of the Fund's policies and the institution itself. Indeed, in retrospect, it became clear that the IMF policies not only exacerbated the downturns but were partially responsible for the onset: excessively rapid financial and capital market liberalization was probably the single most important cause of the crisis, though mistaken policies on the part of the countries themselves played a role as well. Today the IMF acknowledges many, but not all, of its mistakes—its officials realize how dangerous, for instance, excessively rapid capital market liberalization can be—but its change in views comes too late to help the countries afflicted.

The crisis took most observers by surprise. Not long before the crisis, even the IMF had forecast strong growth. Over the preceding three decades East Asia had not only grown faster and done better at reducing poverty than any other region of the world, developed or less developed, but it had also been more stable. It has been spared the ups and downs that mark all market economies. So impressive was its performance that it was widely described as the 'East Asia Miracle'. Indeed, reportedly, so confident had the IMF been about the region that it assigned a loyal staff member as director for the region, as an easy preretirement posting.

When the crisis broke out, it was surprising to note how strongly the IMF and the U.S. Treasury seemed to criticize the countries—according to the IMF, the Asian nations' institutions were rotten, their governments corrupt and wholesale reform was needed. . . .

. . . How, if these countries' institutions were so rotten, had they done so well for so long? The difference in perspectives, between what was known about the region and what the IMF and the Treasury alleged, made little sense, until the debate that had raged over the East Asia. Miracle itself is recalled. The IMF and the World Bank had almost consciously avoided studying the region, though presumably, because of its success, it would have seemed natural for them to turn to it for lessons for others. It was only under pressure from the Japanese that the World Bank had undertaken the study of economic growth in East Asia (the final report was titled The East Asian Miracle) and then only after the Japanese had offered to pay for it. The reason was obvious: The countries had been successful not only in spite of the fact that they had not followed most of the dictates of the Washington Consensus, but because they had not. Though the experts' findings were toned down in the final published report, the World Bank's Asian Miracle study laid out the important roles that the government had played. These were far from the minimalist roles beloved of the Washington Consensus.

There were those, not just in the international financial institutions but in academia, who asked, was there really a miracle? 'All' that East Asia had done was to save heavily and invest well! But this view of the 'miracle' misses the point. No other set of countries around the world had managed to save at such rates *and* invest the funds well. Government policies played an important role in enabling the East Asian nations to accomplish both things simultaneously.

When the crisis broke out, it was almost as if many of the region's critics were glad: their perspective had been vindicated. In a curious disjunction, while they were loath to credit the region's governments with any of the successes of the previous quarter century, they were quick to blame the governments for the failings.

Whether one calls it a miracle or not is beside the point: the increases in incomes and the reductions in poverty in East Asia over the last three decades have been unprecedented. No one visiting these countries can fail to marvel at the developmental transformation, the changes not only in the economy but also in society, reflected in every statistic imaginable. Thirty years ago, thousands of backbreaking rickshaws were pulled for a pittance; today, they are only a tourist attraction, a photo opportunity for the camera-snapping tourists flocking to the region. The combination of high savings rates, government investment in education, and state-directed industrial policy all served to make the region an economic powerhouse. Growth rates were phenomenal for decades and the standard of living rose enormously for tens of millions of people. The benefits of growth were shared widely. There were problems in the way the Asian economies developed, but overall, the governments had devised a strategy that worked, a strategy which had but one item in common with the Washington Consensus, trade was important, but the emphasis was on promoting exports, not removing impediments to imports. Trade was eventually liberalized, but only gradually, as new jobs were created in the export industries. While the Washington Consensus policies emphasized rapid financial and capital market liberalization, the East Asian countries liberalized only gradually—some of the most successful, like China, still have a long way to go. While the Washington Consensus policies emphasized privatization, government at the national and local levels helped create efficient enterprises that played a key role in the success of several of the countries. In the Washington Consensus view, industrial policies, in which governments try to shape the future direction of the economy, are a mistake. But the East Asian governments took that as one of their central responsibilities. In particular, they believed that if they were to close the income gap between themselves and the more developed countries, they had to close the knowledge and technology gap, so they designed education and investment policies to do that. While the Washington Consensus policies paid little attention to inequality, believing that such policies were important for maintaining social cohesion, and that social cohesion was necessary to provide a climate favourable to investment and growth. Most broadly, while the Washington Consensus policies emphasized a minimalist role for government, in East Asia, governments helped shape and direct markets. . . .

Box 16.7 (continued)

. . . If the crises had a familiar pattern, so too did the IMF's responses: it provided huge amounts of money (the total bailout packages, including support from G-7 countries, was $95 billion) so that the countries could sustain the exchange rate. It thought that if the market believed that there was enough money in the coffers, there would be no point in attacking the currency, and thus 'confidence' would be restored. The money served another function: it enabled the countries to provide dollars to the firms that had borrowed from Western bankers to repay the loans. It was thus, in part, a bailout to the international banks as much as it was a bailout to the country; the lenders did not have to face the full consequences of having made bad loans. And in country after country in which the IMF money was used to sustain the exchange rate temporarily at an unsustainable level, there was another consequence: rich people inside the country took advantage of the opportunity to convert their money into dollars at the favourable exchange rate and whisk it abroad. The most egregious example occurred in Russia, after the IMF lent it money in July 1998. But this phenomenon, which is sometimes given the more neural sounding name of 'capital flight,' also played a key role in the previous important crisis, in Mexico during 1994–95.

The IMF combined the money with conditions, in a package which was supposed to rectify the problems that caused the crisis. It is these other ingredients, as much as the money, that are supposed to persuade markets to roll over their loans, and to persuade speculators to look elsewhere for easy targets. The ingredients typically include higher interest rates—in the case of East Asia, much, much higher interest rates—plus cutbacks in government spending and increases in taxes. They also include 'structural reforms,' that is, changes in the structure of the economy which, it is believed, lies behind the country's problems. In the case of East Asia, not only were conditions imposed that mandated hikes in interest rates and cutbacks in spending additional conditions required countries to make political as well as economic changes, major reforms, such as increased openness and transparency and improved financial market regulation, as well as minor reforms, like the abolition of the clove monopoly in Indonesia.

The IMF would claim that imposing these conditions was the responsible thing to do. It was providing billions of dollars; it had a responsibility to make sure not just that it was repaid but that the countries 'did the right thing' to restore their economic health. If structural problems had *caused* the macroeconomic crisis, those problems had to be addressed. The breadth of the conditions meant that the countries accepting Fund aid had to give up a large part of their economic sovereignty. Some of the objections to the IMF programmes was based on this, and the resulting undermining of democracy; and some were based on the fact that the conditions did not (and arguably were not designed to) restore the economies' health. But, some of the conditions had nothing to do with the problem at hand.

The programmes—with all of their conditions and with all of their money—failed. They were supposed to arrest the fall in the exchange rates; but these continued to fall, with hardly a flicker of recognition by the markets that the IMF had 'come to the rescue.' In each case, embarrassed by the failure of its supposed medicine to work, the IMF charged the country with failing to take the necessary reforms seriously. In each case, it announced to the world that there were fundamental problems that had to be addressed before a true recovery could take place. Doing so was like crying fire in a crowded theatre: investors, more convinced by the diagnosis of the problems than by the prescriptions, fled. Rather than restoring confidence that would lead to an inflow of capital into the country, IMF criticism exacerbated the stampede of capital out. Because of this, the perception throughout much of the developing world, is that the IMF itself had become a part of the countries' problem rather than part of the solution. Indeed, in several of the crisis countries, ordinary people as well as many government officials and business people continue to refer to the economic and social storm that hit their nations simply as 'the IMF'—the way one would say 'the plague' or 'the Great Depression.' History is dated by 'before' and 'after' the IMF, just as countries that are devastated by an earthquake or some other natural disaster date events by 'before' or 'after' the earthquake. . . .

Source: Joseph Stiglitz, *Globalization and its Discontents* (London: Allen Lane, 2002). 89–97.

be that such programmes have very serious negative impacts on growth, inflation, income distribution, the social sectors, and poverty. In general, Structural Adjustment Programmes have made matters far worse for countries that have followed them. We have examined the philosophy that governs such adjustment programmes, which is essentially one of liberalization, openness, and greater integration with the new economic world order, and we have found that not just the adjustment programmes themselves, but also the thinking behind them does not take account of specific factors and the context of specific countries. With different sets of political and institutional arrangements governing economic and policy choices, the general policy rules of such programmes often fail to take root in many countries. The prevalence of highly liquid, hot money, which disappears from a country literally overnight, has serious consequences for an economy that are beyond its control.

16.6.2 Further Reading

This is an area where one can find a very large number of books and articles, and cite endless references. With structural adjustment being propagated by both the IMF and the World Bank, both organizations publish numerous reports and publications, looking at policies, offering prescriptions, and examining case studies and much of the literature is easily available on the web. Some of the references listed in this chapter are also very useful. The two special issues of the *Pakistan Journal of Applied Economics*, vols. 10 and 11, published in 1994 and 1995, respectively, have some excellent articles

on the subject which provide a general analysis as well as specific case studies with reference to Pakistan.

David Reed's *Structural Adjustment and the Environment* (Boulder, Colorado: Westview Press, 1992) is an excellent source, and V. Thomas et al. *Restructuring Economies in Distress* (New York: Oxford University Press, 1991). The special volume 19 no. 12, of *World Development*, 1993, had some very good articles which look at the consequences of Structural Adjustment Programmes across the globe. Tariq Banuri's edited *Economic Liberalization: No Panacea* (Oxford: Clarendon Press, 1991) is an outstanding book which looks at the policies of liberalization and openness and contains some excellent articles. The *Economic and Political Weekly*, a journal produced in India, continues to publish some well-researched articles on structural adjustment and should be reviewed regularly. Two articles published by Prabhat Patnaik deserve special mention: 'International Capital and National Economic Policy: A Critique of India's Reforms', *Economic and Political Weekly*, vol. 29, no. 12, 1994, and with C. P. Chandrasekhar, 'Indian Economy Under "Structural Adjustment"', *Economic and Political Weekly*, vol. 30, no. 47, 1995. Also see Prabhat Patnaik's *The Retreat of Unfreedom: Essays on the Emerging World Order* (New Delhi: Tulika, 2003). The book by the winner of the Nobel Prize for Economics in 2001, Joseph Sliglitz entitled, *Globalization and its Discontents* (London: Allen Lane, 2002) is particularly relevant for anyone who wants to review how the IMF has acted in recent years. The websites of the IMF and the World Bank also have a wealth of information which gives information about their numerous programmes.

Appendix 16.1

Changes in Thinking about Development

During most of the latter half of the 20th century, the dominant view among development theorists and development assistance agencies was that people and countries were poor because the countries did not have sufficient capital. Therefore, it was argued, the path to economic growth and development was to transfer capital from the richer countries. It is only recently that there has been a wider understanding that countries lack capital and are poor because they are very unfriendly places for capital (both physical and human capital). It is interesting, therefore, to trace how thinking about the development process has changed over the past 50 years, both in terms of economic theory and in terms of practice within development agencies. However, the change has been a two-way process, with practical experience being reflected in the development of theory, and theoretical developments reflected in changes in the forms of development assistance.

Early mainstream Western ideas about what was important in the economic growth process were dominated by what has become known was the Solow-Swan neociassical model of growth (Solow, 1956). Briefly, this model assumes single output, produced using labour and capital in a constant-returns-to-scale technology with diminishing, and eventually exhausted, marginal returns to each factor. The model predicts that long-run growth rates of per capita income will equal the (assumed) exogenous rate of technical progress. Changes in savings rates or government policies will affect the levels of steady-state output and capital stock but will have no long-run effect on the growth rate. If all countries experience the same rate of exogenous technical progress, they will all converge to a common growth rate over time. Countries with different savings behaviour, institutions, cultural norms, government policies, and so on may be expected to have different levels of steady-state income and different capital-labour ratios, but their long-run growth rates would all be anchored to the common rate of technical progress.

Thus, this model, which was developed with the industrial countries in mind, placed emphasis on physical capital, undifferentiated labour, and technical progress. In early empirical applications to high-income countries, accumulations of physical capital and labour accounted for only about 25 per cent of historical growth. The balance ('residual') was attributed to technical change. There were arguments over whether the technical change was 'embodied' in the physical capital or whether it was exogenous, 'autonomous,' or 'disembodied.'

This theory sat well with the prevailing approach to development assistance at a practical level, which was that countries were poor because they lacked physical capital to go with their abundant labour. Therefore, the principal role of development assistance was to transfer financial capital from the richer countries to the poorer countries, where it would be transformed into physical capital, largely in the form of public infrastructure. Technical change was to a large extent seen as being transferred as 'embodied' in the physical capital. Thus there were arguments over the appropriateness of the technology transferred in this way. This approach to development probably received support from the success of the Marshall Plan in the rapid recovery of western Europe after the devastation of the Second World War. The Marshall Plan's success was essentially seen as the result of the successful transfer of capital to those countries.

The next major change in thinking about the process of economic growth can be seen to grow out of the work of Becker (1964). Becker argued that all labour was not the same, that it was differentiated through education, training, and improvements in health, and that household decisions about these investments in labour could be thought of in an economic framework of human capital. The insights from Becker's household consumption model were soon picked up by the development assistance agencies in the form of projects on education and health. Only later (Mankiw, Romer, and Weil, 1992) were the ideas captured in the economic growth literature by showing that the predictions of the neoclassical model attribute much less importance to the residual if the definition of capital is widened to include human capital.

In the late 1970s there was another major change in development thinking which seems to have grown out of two pieces of empirical research. First, Krueger and Bhagwati's study of the rapid growth of the four 'East Asian Tigers' (see Krueger, 1978) highlighted the importance of policy, particularly openness to international trade and investment. The corollary to their research was that the import substitution policies that had been carried on by most if not all poor countries were not favourable to long-term economic growth. There can be rapid income growth in the early stages of an import substitution strategy as the protected firms expand in capturing the domestic market. However, being internationally uncompetitive, when they saturate the domestic market, income growth slows as the protected firms are unable to export.

The second major jolt to development thinking came from the World Bank where an evaluation of the Bank's completed projects showed that many of them were failures, particularly in the poorest countries in sub-Saharan Africa. The conclusion reached—most likely with the Krueger/Bhagwati research in mind—was that the projects were unsuccessful because the policy environment was unfavourable. Thus developed the concept of the Structural Adjustment Programme and 'conditionality,' with the emphasis on changing the policy regime so that countries were more open to trade and investment, both internally and externally. The focus on 'getting the prices/policies right' was expanded to include macroeconomic policies (which were the focus of the IMF) as well as microeconomic policies (more the focus of the World Bank and the regional banks). Agreement on this approach to development assistance became known as the 'Washington Consensus.'

The focus of development assistance on policies was reflected in the economic growth theory with the development of the so called 'endogenous' growth models in the late 1980s and early 1990s. In these models, technical change is endogenous, an idea that appealed because it could help explain how countries could keep growing at faster rates over long periods, rather than moving towards some static growth rate as in the neoclassical model. An alternative to expanding the capital stock in the neoclassical model is to assume that there are externalities to capital which can spill over to the whole economy and increasing returns to scale such as through 'learning by doing' (Romer, 1986; Lucas, 1988) or research and development (Romer, 1990). For example, in the differentiated-inputs model of Romer (1990) and Grossman and Helpman (1991), growth is faster the larger the scale of the research and development sector. Another implication of external effects and increasing-returns models is that these effects justify government intervention, and such permanent changes in government policy can have permanent effects on the growth rate.

While the focus on the policy environment dominated development assistance efforts in the 1980s and 1990s, changes in the paradigm were underway, stemming from North's (1973, 1990) early focus on the important institutions of an economy. North's work has been given a more practical flavour with the writings of Olson (1996 and 2000) and de Soto (2000). The key idea of this work is that of the overriding importance for economic growth of the basic institutions—public and private, formal and informal, and economic, social, and political—that determine how an economy functions. In this literature, 'institutions' have a particular definition, distinct from the common use that is indistinguishable from 'organizations.' Haggard (1999) describes the difference as follows:

> Institutions refer to the formal and informal rules and enforcement mechanisms that influence the behaviour of organizational and individuals in society. They include constitutions, laws and regulations, and contracts, as well as trust, informal rules and social norms. Organizational are collective social actors, usually characterized by hierarchical patterns of internal authority, that pursue common interests. Organizations operating in the public sphere include government bureaucracies, legislatures, political parties, unions, interest groups, NGOs, and even firms in their political capacities. (p. 30).

In particular, de Soto (2000) has shown that 'getting the policies right' (the focus of the Structural Adjustment Programmes) will be ineffective unless the institutions essential to the participation of all of an economy's income-earning assets (land, labour, capital, and natural resources) are in place. Referring mainly to land and other forms of fixed capital, he says:

> Most people cannot participate in an expanded market because they do not have access to a legal property rights system that represents their assets in a manner that makes them widely transferable and fungible, that allows them to be encumbered and permits their owners to be held accountable. So long as the assets of the majority are not properly documented and tracked by a property bureaucracy, they are invisible and sterile in the marketplace. (210–11)

Institutions are essentially the sets of rules that govern how a society behaves in particular areas of activity. As North (1990) describes them, they range from taboos, customs and traditions in what are called traditional societies to formal, written constitutions and laws governing economic, political and social behaviour in a more modern society. Institutions may be formal—such as a constitution or traffic laws—or they may be informal, such as voluntary codes of conduct of business or social groups. The set of rules making up an institution defines the incentives to which people will respond. According to North (1990) and Hayami and Ruttan (1971), institutions change as the transaction costs of behaving in certain ways change. Transaction costs can be seen to change as economies develop and technologies improve, and as political and social forces within a society change. So, for example, reductions in transport costs—of information or goods—can make certain behaviours more or less costly, and therefore lead to a new form of institution. Or increased trust between individuals and groups can not only improve social cohesion but also lower the costs of transacting contracts.

North emphasized the cost of information in the development of institutions. The provision and communication of information is required to measure the attributes of a good or service in economic exchange and to define and protect the rights that are exchanged. The more costly are the exchange and its enforcements, the higher are the transaction costs, and the less likely is the institution to exist or to be effective.

North (1990), Olson (1996) and de Soto (2000) have stressed the overriding importance of property rights and contract enforcement in economic growth. Well-defined and secure property rights and impartial enforcement of contracts between parties are the basis for a market economy. If individual rights to factors (land, labour, or capital) are ill-defined in legislation and all contracts made between parties to an economic exchange are not impartially enforced by the judicial system-and therefore both property rights and contracts are free from discretionary intervention by politicians and bureaucrats—then the costs of transactions and the costs of transformation in production will make economic activity infeasible or highly suboptimal. In such circumstances, people will be reluctant to invest in fixed assets. The only businesses that will exist will be those that are 'footloose,' i.e. easily shifted to another location. Or private economic activity will only be undertaken with some kind of government guarantee (such as joint ventures with government, where the government will likely bear the business risks involved; or where higher profits to cover the high transaction and transformation costs are assured, such as through some form of import protection). In such circumstances the economic activity may be largely illegal and small-scale, and bribery of government officials frequent, as de Soto (1989) has shown. People will also be unwilling to invest in education, or will only do so if they have prospects of moving to another country where they will be able to earn and retain an income that justifies their investment.

Olson (1996) and de Soto (2000) explain the large and growing gap in incomes between the rich countries and those poor countries where incomes have grown very slowly, if at all, as largely due to the absence of these basic institutions, not to the lack of capital, some inherent deficiency in work ethic, or some culturally-determined behaviour. Prior to its break-up the former Soviet Union had the highest per capita level of education in the world, as measured in terms of the level of schooling reached, and the highest per capita level of plant and machinery. But it remained a poor country. What it lacked was the institutions that allow entrepreneurship and innovation to flourish through effective economic transformation and exchange.

Olson (1996) demonstrates the critical importance of secure property rights and impartial enforcement of contracts. He points out that if the key missing ingredient for development was capital, then the marginal productivity of capital would be higher in poor countries than in rich countries, and private capital would be trying to move from rich to poor countries. In fact, the movement is strongly in the other direction as we see from estimates of 'capital flight.' Similarly, Olson argues that institutions in the rich countries must be the missing ingredient when an individual can migrate from a poor country to a high-income country and soon thereafter earn an income that is many times higher than in their home country and as high as or higher than the average income in the host country. The plane flight does not change migrants' skills and willingness to work as much as it places them in a more friendly environment for their labour and capital (no doubt what applies to labour and capital also applies to technology).

Aron (2000) sums up the institutional constraints in poor countries as follows:

> When institutions are poorly defined or there are few formal institutions, economic activities are restricted to interpersonal exchanges. In such cases, repeat activities and cultural homogeneity facilitate self-enforcement. Transaction costs may be low in such an environment, but transformation costs are high because the economy operates at a very low level of specialization, via social networks, but contracts are still constrained by kinship ties. It is clear, however, that firms or agents in an environment of weak institutions cannot engage in complex, long-term and multiple-contract exchanges with effective enforcement as they do in industrial economies. A basic structure of property rights that encourages long-term contracting appears essential for the creation of capital markets and growth. (105)

While there are many countries where the poor own assets but have no excisable property rights, there are circumstances where the poor do not have any access to potential income-earning assets such as land or even education. In these latter circumstances there has to be some form of asset redistribution or asset creation.

It is not easy for a country to make the substantial changes in institutions or asset redistribution necessary to allow the poor to participate in economic growth and development. The new institutions and land redistribution that established a basis for rapid income growth in Japan, Republic of Korea and Taipei, China was imposed by external forces. In the People's Republic of China and in Viet Nam, which experienced revolutions in agricultural productivity through the changeover from collectivization to individual land rights (leasehold) and the liberalization of agricultural markets, the transformations in institutions were introduced internally but were exceptional in their breadth and speed. As North and Olson have argued, changing the status quo may be very difficult or even impossible without such dramatic intervention, because the vested interests benefitting from the existing situation usually hold political power and therefore have no interest in change. The important question therefore is how to stimulate change in such circumstances.

The 1990s has seen a large degree of attention given by the development community to 'governance.' This focus grew out of the concerns of the World Bank and bilateral donors with corruption in the governments of borrowing countries and the desire by non-political organization like the World Bank to be publicly critical about corruption. As interest in governance has grown, the scope of its definition has broadened. Early on, concerns about governance were mainly focused on the accountability and transparency of government and the political process, and the effectiveness of the government's fiscal and monetary policies.

Economic theorists are incorporating the role of institutions within the economic theory of growth and there is burgeoning empirical research on the relationship between institutional development and economic growth (see Aron, 2000 for a review). Development agencies are beginning to focus on institutional issues. But there is not yet a full commitment to the conclusions that are implicit in de Soto's work. In other words, if basic institutions for the creation of capital and full participation of the whole society in economic activity are not in place, investments in infrastructure, education, health, or

economic reforms, or public sector reforms will not be effective, and will likely only increase income in equality–favouring those who already have access to factor markets. Building roads and bridges or undertaking agricultural research will not increase incomes as much as they could if people do not have secure property rights to farm land; education and health improvement projects will not promote income growth for the poor unless there is the generation of capital with which the healthier and better educated labour force can work; privatization of public enterprises will be less than fully effective if there are not secure property rights to land and enforcement of contracts; laying off public officials with redundancy packages could see them become the new entrepreneurial class but won't if they cannot gain secure access to land and raise additional capital through securitization of their assets; and trade and investment policy reform will see disappointing results in the form of supply responses unless there is security of property rights and contracts and capital markets are developed so that traders can raise capital and hedge their commodity and currency risks.

Therefore, in going about their business, particularly to ensure economic growth in which all will participate, development agencies have to have a fundamental re-examination of the prospects of success fir their traditional forms of lending and aid. They have to examine whether there are appropriate institutions in place so that investments have a good chance of being successful. They also have to evaluate the possibilities for assisting the creation and redistribution of income-earning assets within a country so that the poor have the chance to participate more fully in the growth process. To carry out this evaluation, development assistance agencies have to be able to define more clearly the constraints impeding participation by the poor and place priorities on the removal of these constraints.

Source: Ronald Duncan and Stephen J. Pollard, 'A Conceptual Framework for Designing a Country' Poverty Reduction Strategy', paper prepared for the Asia and Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction (Manila: Asian Development Bank, February 2001).

Appendix 16.2

The Role of the IMF and the World Bank

Professor Prabhat Patnaik and C. P. Chandrasekhar look at how the IMF and World Bank have come to influence our economies in such a major way.

Among radical economists there is a tendency to lump the Fund and the Bank together as entities indistinguishable from one another, and to think of them as having remained more or less immutable over time. Nothing however could be further from the truth. There were significant differences between the Fund and the Bank which have narrowed over time, and the reasons for this narrowing constitute an important element of contemporary political economy. And each of these institutions has changed in crucial ways through time.

The Bank of course has always been opposed to any attempts on the part of the third world countries to break away through conscious design (which necessarily means conscious state intervention) from the pattern of international division of labour inherited from the days of colonialism and semi-colonialism. If such a break is to be achieved then it must be achieved, according to its perception, entirely through the mediation of the market forces, which means in particular through the medilections of direct foreign investment. The Bank has remained absolutely faithful to this position of opposing state-intervention-sponsored industrialization, despite the fact that historical evidence marshalled earlier by Gerschenkron and subsequently by many others shows overwhelmingly that successful industrialization by late-industrializers has invariably depended upon active state intervention. What has changed in the case of the Bank over time is: first, the specific argument on the basis of which it has expressed its opposition to state-sponsored industrialization; secondly, the precise tactics it has brought to bear in order to undermine state-sponsored industrialization in third world countries; and thirdly, the precise package of programmes around this basic objective, reflecting as we shall see the changing nature of world capitalism.

The arguments, which of course were not mutually exclusive, though different ones received emphasis at different points of time, kept altering in the following manner: in the late-1950s and the early 1960s there was a macro-argument that substantial unutilized capacity in the industrial sector existed because of a scarcity of foreign exchange so that a combination of import liberalization and exchange rate devaluation would set up a virtuous circle of 'more imports–more capacity utilization–more exports–still more imports' and so on, which would unshackle the economy from the clutches of dirigisme (which was predicated inter alia upon a recognition of demand constraints both in the external and in the internal markets). This was the argument on the basis of which the World Bank pushed the Indian government into adopting an import-liberalization-cum-devaluation package in 1966 with disastrous consequences.

In the McNamara years the emphasis shifted to poverty. But the concern for poverty did not express itself in terms of any argument in favour of an egalitarian alteration in asset or land distribution; it expressed itself in the argument that the domestic intersectoral terms of trade were more unfavourable for agriculture vis-à-vis industry than the terms of trade prevailing in the world market, so that removing trade restrictions and thereby preventing state-sponsored industrialization would benefit the agricultural sector which is the repository of mass poverty. This argument was backed up by another one, namely, since the inequality in urban income distribution was larger than that in rural income distribution, a shift in income distribution from the urban to the rural sector, which means in effect from industry to agriculture, would have the effect of lowering overall income inequalities. This argument amounted yet again to an attack

on state-sponsored industrialization; the vacuousness of this argument lay inter alia in the fact that nearly 60 per cent of the agriculture-dependent population in a country like India, being net buyers of food grains in the market and belonging to the poorest segment of society, would be actually harmed by a rise in food prices in terms of their wage-unit.

More recently the Bank has shifted to the well known micro-theoretic 'marketist' argument which focuses on the allegedly interrelated phenomena of 'onward orientation', 'price-distortion', and 'inefficiency'. Much has been written on the vacuousness of this critique: 'outward orientation' as manifested for example in successful export performance has been accompanied by highly state-interventionist neo-merchantilist policies rather than any attempt to 'get prices right' in the conventional sense; the alleged 'inefficiency' of dirigiste industrialization is established through dubious statistical exercises involving dubious concepts such as 'total factor productivity' (which is predicated upon the perennial absence of any demand constraint); there is complete silence on the role of the domestic investment effort in explaining growth performance, notwithstanding the overwhelming evidence which exists on its importance, and so on. We shall not dilate on this critique here; the point to note is that the policy-package following from this critique is exactly the same as before, namely, to roll back state-sponsored industrialization.

Where the Bank did change was in two respects; the first relates to its tactics. In the beginning, up until the end of the 1950s in the case of India, the Bank studiously avoided giving any loans for government programmes. In the early 1960s it modified its stance to give loans for social infrastructure projects, but not for any public sector industrial undertakings. It is only when the policy of boycott of public sector undertakings appeared to be counterproductive from its point of view that it started financing investment in such undertakings but with its own conditionalities, such as global tendering, specifying technological details and the scale of plants, etc. This shift from 'boycotting' to 'infiltrating' the public sector enabled it to exercise great leverage, to induct multinational corporations (MNCs) directly into the public sector as collaborators, to undermine domestic technological self-reliance and indigenous technological capabilities, to dictate pricing policies and acquire an indirect say on the government budget, and to set up 'networks' with bureaucrats and managerial personnel of the public sector. Together with this began the process of World Bank employees shifting to key government positions, especially in the ministry of finance, even as they were drawing pensions from the Bank, or even as they kept open the option of moving back to the Bank. They provided a powerful lobby working in concert towards 'liberalization-cum-structural adjustment' (arguably, as mentioned earlier, pushing the country into a trap where these policies became inevitable).

The other respect in which the Bank did change was in its new insistence upon a range of financial sector reforms whose overall objective again was to detach the domestic financial institutions and the financial markets from their integration into the domestic development effort (through, for example, low long-term interest rates, subsidized credit, and minimum percentage, credit disbursements for 'priority sectors' such as agriculture, etc.) and to integrate them more closely instead with global financial markets. Together with this went the Bank's demand for privatization not only of the financial domain where the public institutions held sway, but of public sector assets including of natural resources. The economic, as opposed to the ideological, argument for privatization was again utterly dubious: as a means of closing the fiscal deficit it was no different from money created directly for the government's use; as a means of reducing the government's interest burden it could work only under the palpably impossible condition that the rate of return sacrificed on the sold government assets was lower than the interest rate on public debt (which is impossible because the market would never buy assets at such low rates of return, and in practice of course has insisted on obtaining public assets only at virtually throw-away prices); and as a means of introducing 'entrepreneurship' it was of no use because the buyers were either 'fly-by-night-operators', or, if reputable MNCs, had more complex objectives (on which more later).

This widening of the Bank's package, from simply rolling back state-sponsored industrialization through a removal of trade restrictions, government controls and the pre-eminence of the public sector, to an integration of the domestic economy to the operations of global finance, reflected a fundamental change that was taking place within world capitalism itself, namely, a tendency towards greatly increased fluidity of finance across national boundaries, a tendency in short towards a globalization of finance, which is very different from, though often confused with, globalization of production facilities.

This very tendency also explains the shift which was taking place in the position of the IMF as well. Earlier the IMF was exclusively concerned with 'stabilization'. The Polak model, for example, which provided the basis for the IMF's policy-prescriptions concentrated on a few macrolevel identities and made no attempts at modelling 'structural adjustment'. Its assumptions were questionable (e.g. the absence of any recognition of a demand constraint, the attribution of external payments problems exclusively to the government sector's deficit, and the general monetarist bias) but it provided the tool-kit for a highly conservative financial institution whose sole concern, especially vis-à-vis third world countries, was to recover its loans by imposing fiscal discipline upon the latter. This ruthless conservatism drew the ire of the third world, and indeed of radicals everywhere. But it was the conservatism of a narrow-minded financier, not that of an ideologue of development frowning overtly upon any attempt to alter forcibly the colonial pattern of international division of labour. The latter role was left by and large to the World Bank.

A major change took place between the two oil-shocks. While the recycling of resources to the third world, such as it was, was organized in the wake of the first oil-shock by the IMF itself, the tremendous growth which took place in the role of the banks in the interim meant that by the time of the second oil-shock it was the banks which were doing whatever recycling was to be done, and the IMF was called upon only to provide 'security cover' to the banks. This was the beginning of a process; from being a leading financier the

IMF had got reduced to being a 'gendarme' of international rentier interests. As a 'gendarme' then it had to insist that the countries, which were caught under its 'conditionalities' and thereby became possible candidates for receiving funds from international rentiers, adopted a host of measures that were to the liking of the rentiers, such as privatization of public assets, 'opening up' of financial markets, removal of exchange restrictions, convertibility of the currency on the current and capital accounts, and so on, all of which amounted to an espousal of the kind of 'structural adjustment' which the World Bank had also come around to.

To sum up then, while the conservatism of the Bretton Woods institutions has continued unabated, there have been major changes in the precise texture of this conservatism reflecting changes which have been occurring in world capitalism. Not only have the Fund and the Bank come closer together in terms of outlook, breaking down their earlier separateness, but this coming together has itself been promoted to a significant extent by the vastly enhanced role of globalized finance. On might even add that this ascendancy of globalized finance has been responsible, inter alia, for keeping down willy-nilly what Lenin would have called 'inter-imperialist rivalry': certainly as far as the third world is concerned, the governments of the advanced capitalist countries present a remarkably common front and give more or less unanimous support to the structural adjustment measures being imposed by the Bretton Woods institutions.

Source: Patnaik, Prabhat and C. P. Chandrasekhar, 'Indian Economy Under "Structural Adjustment"', *Economic and Political Weekly*, vol. 30, no. 47, 1995, 3002–4.

Notes

1. This section and sections 16.2, 16.3, and 16.4 are drawn from my paper, Zaidi, S. Akbar, 'The Structural Adjustment Programme and Pakistan: External Influence or Internal Acquiescence?', *Pakistan Journal of Applied Economics*, vol. 10, nos. 1 and 2, 1994.
2. Reed, David, *Structural Adjustment and the Environment* (Boulder, Colorado: Westview Press, 1992), 4.
3. While the emphasis of this new thinking has been on removing protectionism and making economies more open, most underdeveloped countries still face severe restrictions. Some 51 per cent of Pakistan's exports to the US, 53 per cent to the EU, and 11 per cent to Japan are subject to quota restrictions: see Nabi, Ijaz and Naved Hamid, 'Partnership in Pakistan', in Lele, M. and Ijaz Nabi (eds.), *Transitions in Development: The Role of Aid and Commercial Flows* (San Francisco: ICEG Press, 1991). However, one must add that, with the end of GATT and the birth of the World Trade Organization, international quotas are going to become minimal.
4. This section is drawn from Zaidi, S. Akbar, op. cit., 1994 and from Reed, David, op. cit., 1992. See Reed, David, op. cit., 1992, for a more detailed historical account.
5. For more details see: V. Thomas et al. 1991; *Restructuring Economies in Distress*, (New York: Oxford University Press, 1991); Ferreira, F., 'The World Bank and the Study of Stabilization and Structural Adjustment in LDCs', DEP No. 41, *Development Economics Research Programme*, STICERD, (London School of Economics, 1992); Reed, David, op. cit., 1992; World Bank, *Pakistan: Growth Through Adjustment*, Report No. 7118-Pak (Washington DC, 1988); World Bank, *Pakistan: Medium-Term Economic Policy Adjustments*, Report No. 7591-Pak (Washington DC, 1989); World Bank, *Adjustment Lending Policies for Sustainable Growth*, Policy and Research Studies No. 14, (Washington DC, 1990); and World Bank, *Adjustment Lending and Mobilization of Private and Public Resources for Growth*, Policy and Research Studies No. 22, (Washington DC, 1992).
6. Khan, Mohsin S., 'The Macroeconomic Effects of Fund-Supported Adjustment Programmes', *IMF Staff Papers*, vol. 37, no. 2, 1990; V. Thomas et al. op. cit., 1991; World Bank, op. cit., 1990; World Bank, op. cit., 1992.
7. Khan, Mohsin, S., op. cit., 1990, 222, emphasis added.
8. V. Thomas et al. op. cit., 1991, 544.
9. Ibid. 39.
10. Reed, David, op. cit., 1992, 24.
11. V. Thomas et al. op. cit., 1991, 14.
12. Reed, David, op. cit., 1992, 32, emphasis added.
13. Ibid. 32.
14. Ibid. 32.
15. Ibid. 37.
16. G. K. Helleiner et al. 'IMF Adjustment Policies and Approaches and the Needs of Children', *World Development*, vol. 19, no. 12, 1991, 1825.
17. Ibid. 1826; see also Stewart, Francis, 'The Many Faces of Adjustment', *World Development*, vol. 19, no. 12, 1991.
18. Hoeven, R. Van der, 'Adjustment with a Human Face: Still Relevant or Overtaken by Events?', *World Development*, vol. 19, no. 12, 1991, 1835.
19. Veltmeyer, V., 'Liberalization and Structural Adjustment in Latin America: In Search of an Alternative', *Economic and Political Weekly*, vol. 28, no. 39, 1993, 2082.
20. Ibid. 2083.
21. Senses, F., 'Turkey's Stabilization and Structural Adjustment Programme in Retrospect and Prospect', *The Developing Economies*, vol. 29, no. 3, 1991, 26.
22. Ibid. 226.
23. See also Stewart, Francis, op. cit., 1991; and Zuckerman, E., 'The Social Cost of Adjustment', in Thomas, V et al. op. cit., 1991.
24. See Reed, David, op. cit., 1992.
25. Patnaik, Prabhat and C. P. Chandrasekhar, 'Indian Economy Under "Structural Adjustment"', *Economic and Political Weekly*, vol. 30, no. 47, 1995, 3007.
26. Ibid. 3008.
27. Stewart, Francis, op. cit., 1991, 1848, emphasis added.
28. Ibid., 1848, emphasis added.
29. Reed, David, op. cit., 1992, 9.
30. Ibid. 36.
31. Quoted in Stewart, Francis, op. cit., 1991, 1858.

32. de Tray, D., 'Comments', in V. Thomas et al. op. cit., 1991, 72, emphasis added.
33. Ibid., 273, emphasis added.
34. Reed, David, op. cit., 1992, 17.
35. Ferreira, F., op. cit., 1992, 53.
36. Veltmeyer, V., op. cit., 1993, 2080.
37. Salop, J., 'Reducing Poverty; Spreading the Word', *Finance and Development*, December 1992, 3.
38. Parts of this section are drawn from Banuri, Tariq, *Economic Liberalization: No Panacea* (Oxford: Clarendon Press, 1991), which should be consulted for a more extensive elaboration.
39. See Hughes, Alan and Ajit Singh, 'The World Economic Showdown and the Asian and Latin American Economies: A Comparative Analysis of Economic Structure, Policy and Performance', in Banuri, Tariq, op. cit., 1991.
40. Ibid.
41. See Banuri, Tariq, op. cit., 1991, especially chapters 1, 2, and 6.
42. Platteau, Jean-Philippe, 'Formalization and Privatization of Land Rights in Sub-Saharan Africa: A Critique of Current Orthodoxies and Structural Adjustment Programmes', DEP No. 34, *Development Economics Research Programme*, STICERD (London School of Economics, 1992); and Institute of Development Economics, 'The Political Analysis of Markets', *IDS Bulletin*, vol. 24, no. 3, 1993.
43. Reed, David, op. cit., 1992, 34, emphasis added.
44. V. Thomas et al. op. cit., 1991, 524, emphasis added.
45. See Zevin in Banuri, Tariq and Juliet Schor, *Financial Openness and National Autonomy* (Delhi: Oxford University Press, 1992).
46. See Patnaik, Prabhat, 'International Capital and National Economic Policy: A Critique of India's Reforms', *Economic and Political Weekly*, vol. 29, no. 12, 1994.

17 The IMF and Structural Adjustment Programmes in Pakistan

It is fair to say that since 1988 Pakistan's economic policies, management, and performance have been highly influenced by the country's adherence to the IMF/World Bank-sponsored Structural Adjustment Programmes, and to neo-liberalism. It is also fair to say that during this period Pakistan's various governments have had no independent or original economic programme of their own. Almost without exception, the policy measures undertaken by the various governments in power since the implementation of the 1988 programme follow very closely the details in the Policy Framework Papers, which outline steps that the government is to undertake after signing the Structural Adjustment Programme or, more recently in 2008 in the Stand-By Arrangement (SBA) document. The programmes and agreements and arrangements are so minutely detailed that the government has little need to be innovative, and merely follows steps that are incorporated in the programme document, and such agreements and programmes are only terminated, as they have been in the past, when the government in Pakistan is unable to fulfil its obligations and commitment to the Fund. While the period since 1988 can be termed 'economic management under Structural Adjustment Programmes', Pakistan has had recourse to earlier programmes as well. However, there is a very marked difference in the constitution and application of the programmes prior to, and post, 1988. The purpose of this chapter is to document and highlight the role that Structural Adjustment Programmes have played in Pakistan and the impact of neo-liberalism, more broadly. As will become clear, profound and substantial changes have had to be made in Pakistan's economy over the last few years in order to have more IMF/World Bank loans released. The chapter also includes an evaluation based on the perceptions of the donors and implementers (the IMF and the World Bank) themselves, and tries to assess the impact of the Structural Adjustment Programmes on Pakistan's economy and society.

17.1 History[1]

Pakistan has had a long association with the IMF, and the first time that the Government of Pakistan asked for a loan was in 1958 (see Tables 17.1 and 17.2). This was a standby arrangement worth SDR25 million[2] over a period of about ten months. However, the loan was cancelled prior to the expiration date and the entire amount of the loan went unused. Two more standby arrangements, both of a duration of one year, were made in 1965 and 1968 by the Ayub Khan government, worth more than SDR125 million. The Z. A. Bhutto government was granted four stand-by loans collectively worth SD R330 million. However, as was argued in the previous chapter, stabilization and Structural Adjustment Programmes funded by the IMF did not play a critical role in the management of the economies of the developing countries before the mid-1970s. Pakistan's experience also follows the same general trend, where in twenty years since 1958 it had recourse to less than SD R460 million. In the case of Pakistan, as in other developing countries, the nature and extent of the IMF involvement changed drastically in the 1980s.

As the IMF's funding amount and pattern changed over the late 1970s and 1980s, Pakistan entered into a long-term Extended Fund Facility (EFF) in November 1980, under General Zia, for a period of three years. It was worth SDR1.27 billion, three times the entire amount lent between 1947 and 1980. This three-year agreement was cancelled after one year, and a new agreement worth the undrawn amount for two years was signed the very next day. The second recourse to a long-term agreement with the IMF, following which the various governments in Pakistan have very closely followed the programme, was signed by the interim government after the death of General Zia ul-Haq. In fact, it was literally the last day of the government when the agreement was signed, and the subsequently elected Prime Minister, Benazir Bhutto, took office the following day. Her (first) government then ratified the already agreed programme, which ran from 28 December 1988 to 27 December 1991. Analysts argued at the time of Ms Bhutto taking office that her selection as Prime Minister was preconditioned on, amongst other things, the ratification of the programme. Following her ouster after twenty months in office, the Nawaz Sharif government elected in 1990 was bound by the covenants of the agreement, and had to follow it through.

There was a gap of almost two years before another agreement was signed in September 1993. Although this was a one-year standby agreement, it is considered to be a forerunner to the more extensive subsequent agreement, worth almost SDR one billion, signed in February 1994. However, Pakistan's political history since 1993 will help put the Structural Adjustment Programme in proper context.

The first Nawaz Sharif government was dismissed on 18 July 1993, and another interim government was put together in Islamabad. It was headed by Moeen Qureshi, a former World Bank staff member who had been settled in the United States for the previous thirty years. The enhanced Structural Adjustment Programme was prepared by his interim government, and by 30 August 1993, IMF and World Bank staff, representing both the IMF and the

Table 17.1
Pakistan: Transactions with the Fund from 01 May 1984 to 31 May 2012

(in SDRs)

Year	GRA Disbursements	GRA Repurchases	GRA Charges Paid	PRGT Disbursements	PRGT Repayments	PRGT Interest Paid	Total Disbursements	Total Repayments	Total Charges/ Interest Paid
2012	-	516,850,000	46,910,586	-	68,912,000	-	-	585,762,000	46,910,586
2011	-	-	111,675,655	-	172,284,000	-	-	172,284,000	111,675,655
2010	1,063,682,010	-	82,726,174	-	172,284,000	67,025	1,063,682,010	172,284,000	82,793,199
2009	2,101,935,000	4,740,000	38,778,797	-	141,619,000	3,455,930	2,101,935,000	146,359,000	42,234,727
2008	2,067,400,000	11,059,163	513,407	-	105,099,000	4,091,192	2,067,400,000	116,158,163	4,604,599
2007	-	18,956,664	1,574,553	-	78,920,000	4,516,324	-	97,876,664	6,090,877
2006	-	18,956,668	2,318,065	-	53,074,000	4,813,785	-	72,030,668	7,131,850
2005	-	110,831,668	4,164,520	-	53,074,000	5,063,772	-	163,905,668	9,228,292
2004	-	309,364,998	9,009,463	172,280,000	73,613,000	4,952,433	172,280,000	382,977,998	13,961,896
2003	-	351,725,002	16,654,997	344,560,000	68,559,000	3,878,683	344,560,000	420,284,002	20,533,680
2002	-	167,390,835	27,223,896	258,420,000	34,440,000	2,688,228	258,420,000	201,830,835	29,912,124
2001	315,000,000	80,810,834	37,676,953	86,160,000	56,292,000	3,052,643	401,160,000	137,102,834	40,729,596
2000	150,000,000	161,180,834	36,789,119	-	56,292,000	1,145,301	150,000,000	217,472,834	37,934,420
1999	409,580,000	107,600,834	29,581,593	37,910,000	64,740,000	2,574,964	447,490,000	172,340,834	32,156,557
1998	18,950,000	39,712,500	22,961,473	113,730,000	76,482,000	2,607,224	132,680,000	116,194,500	25,568,697
1997	91,490,000	138,775,000	24,481,727	113,730,000	87,408,000	2,104,799	205,220,000	226,183,000	26,586,526
1996	107,160,000	166,975,000	25,132,196	-	54,630,000	3,593,734	107,160,000	221,605,000	28,725,930
1995	133,950,000	61,200,000	26,901,693	-	54,630,000	2,604,865	133,950,000	115,830,000	29,506,558
1994	123,200,000	34,142,500	23,500,566	172,200,000	10,926,000	1,097,738	295,400,000	45,068,500	24,598,304
1993	88,000,000	91,360,000	23,528,612	-	-	1,912,045	88,000,000	91,360,000	25,440,657
1992	189,550,000	116,060,837	23,100,480	-	-	1,912,048	189,550,000	116,060,837	25,012,528
1991	122,400,000	71,656,567	24,974,639	109,260,000	887,310	2,075,937	231,660,000	72,543,877	27,050,576
1990	-	108,135,726	37,523,534	-	14,264,500	1,019,704	-	122,400,226	38,543,238
1989	194,480,000	143,135,726	42,024,129	273,150,000	26,273,000	459,942	467,630,000	169,408,726	42,484,071
1988	-	196,588,385	38,774,862	-	39,173,293	160,975	-	235,761,678	38,935,837
1987	-	280,288,384	54,821,518	-	45,753,294	483,824	-	326,041,678	55,305,342
1986	-	269,524,830	82,734,829	-	45,753,294	712,556	-	315,278,124	83,447,385
1985	-	149,194,719	112,970,224	-	31,488,794	929,442	-	180,683,513	113,899,666
1984	-	51,571,846	73,407,466	-	9,740,147	1,048,966	-	61,311,993	74,456,432

Source: http://www.imf.org/external/np/fin/tad/extrans1.aspx?memberKey1=760&endDate=2012%2D07%2D01&finposition_flag=YES

IMF Agreement 2008

Table 17.1 contd.

Pakistan: Financial Position in the Fund as of 31 May 2012

Summary of IMF members' quota, reserve position, SDR holdings, outstanding credit, recent lending arrangements, projected payments due to the IMF, and monthly historical transactions with the Fund.

I. Membership Status: Joined: July 11, 1950 — Article VIII

II. General Reserve Account	**SDR Million**	**% Quota**
Quota	1,033.70	100.00
Fund holdings of currency (exchange rate)	5,749.75	556.23
Reserve tranche position	0.12	0.01

III. SDR Department	**SDR Million**	**%Allocation**
Net cumulative allocation	988.56	100.00
Holdings	639.06	64.65

IV. Outstanding Purchase and Loans	**SDR Million**	**% Quota**
Stand-by arrangements	4,419.19	427.51
Emergency assistance[1]	296.98	28.73
ECF arrangements	198.12	19.17

V. Latest Financial Arrangements[2]

Type Stand-By	Date of arrangement	Expiration Date	Amount Approved	Amount Drawn SDR Million
Stand-By	24 November 2008	30 September 2011	7,235.90	4,936.04
ECF[3]	05 December 2001	5 December 2004	1,033.70	861.42
Stand-By	29 November 2001	30 September 2001	465.00	465.00

VI. Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs)

	2012	2013	2014	2015	2016
Principal	832.35	2,399.61	1,379.29	303.04	–
Charges	40.83	43.38	13.96	2.45	0.47
Total	873.17	2,442.99	1,393.25	305.49	0.47

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Prepared by Finance Department, IMF

Source: http://www.imf.org/external/np/fin/tad/exfin2.aspx?memberkey1=760&date1Key=2012-05-31 International Monetary Fund

Notes

1. Emergency assistance may include ENDA, EPCA, and RFI.
2. Formerly PRGF
3. When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Table 17.2
IMF Arrangements with Pakistan (Standby, Extended, Structural Adjustment, and Enhanced Structural Adjustment Arrangements)

Panel A

Date of arrangement	Type of arrangement	Date of expiration or cancellation	Amount agreed (SDRm)	Amount drawn (SDRm)	Undrawn balance (SDRm)
8 Dec. 1958	Standby	22 Sept. 1969[a]	25.00	–	25.00[a]
16 Mar. 1965	Standby	16 Mar. 1966	37.50	37.50	–
17 Oct. 1968	Standby	16 Oct. 1969	75.00	75.00	–
18 May 1972	Standby	17 May 1973	100.00	84.00	16.00
11 Aug. 1973	Standby	10 Aug. 1974	75.00	75.00	–
11 Nov. 1974	Standby	10 Nov. 1975	75.00	75.00	–
9 Mar. 1977	Standby	8 Mar. 1978	80.00	80.00	–
24 Nov. 1980	EFF	1 Dec. 1981[a]	1,268.00	349.00	919.00[a]
2 Dec. 1981	EFF	23 Nov. 1983	919.00	730.00	189.00
28 Dec. 1988	Standby	30 Nov. 1990[b]	273.15	194.48	78.67
28 Dec. 1988	SAF	27 Dec. 1991	382.41[c]	273.15	109.26
16 Sept. 1993	Standby	15 Sept. 1994	265.40	88.00	177.40
22 Feb. 1994	EFF	21 Feb. 1997	379.10	80.55	298.55[d]
22 Feb. 1994	ESAF	21 Feb. 1997	606.60	101.10	505.50[d]

[a]Cancelled prior to expiration date.
[b]Extended from 27 March 1990 to 30 June 1990, and again to 30 November 1990.
[c]Approved amount increased from SDR346.9m in March 1989.
[d]As of 31 July 1994.
Source: Zaman, Arshad, 'The Government's Present Agreement with the IMF: Misgovernment or Folly?', *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995, 81.

Panel B

	IMF Programme	To Run For (Coverage)	Total Amount US$ million Sanctioned	Drawn	Completed/Delayed/Suspended
1.	Structural Adjustment Facility (SAF)	1988–1991 (3 years)	516	516	Completed after delay of one year.
2.	Stand-by Arrangement (SBA)	1988–1991 (3 years)	259	259	Completed after delay of one year.
3.	Contingency & Compensatory Financing Facility (CCFF)	1991–1992 (one time)	171.6	171.6	One time facility in one tranche.
4.	Emergency Assistance	1992–1993 (one time)	262	262	One time drawn in one tranche.
5.	Stand-by Arrangement (SBA)	1993–1994 (1–1½ years)	377	125.5	Suspended in 1993.
6.	Enhanced Structural Adjustment Facility (ESAF)	1993–1996 (3 years)	849	290	Suspended after about a year plus.
7.	Extended Fund Facility (EFF)	1993–1996 (3 years)	531	177	Suspended after about a year plus.
8.	Stand-by Arrangement (SBA)	1995–1997 (1–1½ years)	600 216	277 150	1. Programme suspended in March 1996. 2. Programme reactivated in Dec. 1996. 3. Again suspended in 1997.
9.	Enhanced Structural Adjustment Faciliy (ESAF)	1997–2000 (3 years)	935	310	Suspended in October 1997.
10.	Extended Fund Facility (EFF)	1997–2000 (3 years)	623	77	Suspended in October 1997.
11.	Enhanced Structural Adjustment Facility (ESAF). (Reactivation of 1997 programme)	1998–2001 (3 years)	637	53	Suspended after nuclear test in May 1998 and reactivated in January 1999. Again suspended in September 1999.
12.	Extended Fund Facility (EFF). (Reactivation of 1997 programme)	1998–2001 (3 years)	557	77.6	Suspended after nuclear test in May 1998 and reactivated in January 1999. Again suspended in September 1999.
13.	Contingency & Compensatory Financing Facility (CCFF)	January 1999 (one time)	495	495	Completed in one tranche drawn.
14.	Stand-by Arrangement	November 2000–September 2001 (ten months)			First full programme to be completed.
15.	Poverty Reduction Growth Facility (PRGF)	December 2001–December 2004 (3 years)	1,300		Fulfilled and completed prior to termination date.
16.	Stand-by Arrangement	November 2008–December 2010 (August 2009) (additional 3,200)	7,600		Suspended in September 2010, aborted in 2011.
17.	Extended Fund Facility	September 2013–September 2016 (3 years)	6,640	–	–

Source: State Bank of Pakistan, *Annual Reports* (Karachi: various issues).

Government of Pakistan, had agreed to a Policy Framework Paper, which laid the basis of the more comprehensive three-year programme of 1994. A number of improprieties were recorded in the process of forming the programme. As Arshad Zaman argues, since Moeen Qureshi was a World Bank member who had recently retired, his government's position was explained by his IMF and World Bank colleagues, who acted in an informal capacity as advisers to the government officials themselves. This, Arshad Zaman argues, 'is not only contrary to conflict of interest rules of the IMF/WB, but also raises important legal questions about the validity of the letter of intent signed by the subsequent government, if it can be established that the letter was drafted not by government officials [as per procedure] but by staff members of IMF/WB'.[3] There was so much overlapping of interests over the content of the programme that it became difficult to see whether the Government of Pakistan was initiating the programme based on its own particular needs and priorities, or whether the IMF and World Bank members, in their official and non-official capacities, were imposing the programme. In the Board meeting of the IMF held in February 1994, when Pakistan's loan came up for discussion and was approved, one of the Executive Directors was quite pleased that the proposed programme initiated by the Moeen Qureshi caretaker government was prepared with such 'close cooperation of the Fund'.[4]

The Moeen Qureshi government was given a standby loan of SDR265.4 million in record time by the IMF on 16 September 1993. For the second time, after her re-election, Ms Benazir Bhutto's government was handed a pre-prepared, detailed programme, which she was expected to endorse. Not only did her government endorse the 1993 programme, but also, within four months, signed the three-year loan under the Extended Fund Facility (EFF) and the Enhanced Structural Adjustment Fund (ESAF). Although this programme was signed by the elected government of Benazir Bhutto, there is little doubt that the unelected Moeen Qureshi interim government was responsible for framing the programme and getting it approved. Ms Bhutto's government rubber-stamped an agreement in which, quite probably, her political future was at stake.[5]

The first time a democratically elected government itself took a loan from the IMF, was Nawaz Sharif's second government of 1997–99. As Panel B in Table 17.2 shows, there were four agreements, two ESAFs and two EFFs, but as in the past, all agreements were suspended or abrogated and were never fulfilled. In fact, as Panel B shows, none of the governments since 1988—with the exception of Nawaz Sharif's second government which used a one tranche $495 million Contingency and Compensatory Financing Facility—completed its programmes and fulfilled the agreements. The only exception was General Musharraf's government, which agreed to a Poverty Reduction and Growth Fund arrangement worth US$1.3 billion (which is equivalent to 100 per cent of the SDR quota of Pakistan) over the period December 2001 to December 2004. In fact, the government prided itself, for this large loan that came about only as a result of 'the completion of SBA in September 2001 [which] was the first-ever successful conclusion to an IMF programme during the last ten years'.[6] As it is, General Musharraf's government congratulated itself for completing most conditionalities well before the period of the agreement came to an end in December 2004—see Appendix 17.1 for details on General Musharraf's government's agreement with the IMF; see also Chapter 18, which presents more details of macroeconomic developments over the period 1998–2013.

While the government of General Pervez Musharraf (1999–2008) was correct in stating that in the past Pakistan was known as a 'one-tranche' country, never fulfilling its entire programme or commitments to the IMF and the World Bank, this claim is only half true. It is true that in the past, governments from 1988 to 1999 were hesitant and that there was incomplete governmental implementation of the tough and unpopular adjustment measures, nevertheless, they did follow IMF/World Bank policies. The core policy measures—devaluation; price, exchange rate, interest rate, and trade liberalization; public enterprise reform; and subsidy withdrawal—which are integral to the so called 'reform' process enforced by the IMF and the World Bank—were implemented by governments in this period, however reluctant they may have been initially in carrying out these policies, and however slowly they may have moved in implementation. It is very difficult to sustain the view—emphasized by the government of General Pervez Musharraf—that previous governments have refused to implement the adjustment measures prescribed to them.

It should be clear from the above account that there are major political connotations to Structural Adjustment Programmes in the context of Pakistan, something that is also confirmed by events after 9/11—see Chapter 18. A number of domestic and foreign interests and forces are also at work, and one wonders how much autonomy the Government of Pakistan has had in the first place. The 1988 and 1993 agreements, which have quite drastically changed the course of Pakistan's economy, were agreed by for the most part (or, some believe, imposed on) unelected, interim governments. It seems that the elected governments that followed the Structural Adjustment Programmes may have been asked to give guarantees that they would not undo a programme designed by someone else. A more detailed analysis of the political and other consequences is reserved for later, and we turn to some details about Pakistan's 1988 and 1994 programmes.[7] The latest agreement with the IMF, the 2008 Stand-By Agreement signed by the Pakistan People's Party government, is also discussed below. Furthermore, Chapter 18 presents additional details when we look at the broad macroeconomic developments between 1998–2013.

17.2 Implementation of the Structural Adjustment Programmes in Pakistan: An examination of the 1988 Programme

In the first edition of *Issues* published in 1999 we provided a very extensive table which appeared as Appendix 15.1, which gave details of the main features of the Structural Adjustment Programme of 1988, signed between the Government of Pakistan and the IMF. The reason why the table was presented in such detail was to show how particular and specific a Structural Adjustment Programme really is. It goes into minute details on almost every account. For example, there are references to as mundane and apparently trivial concerns as telephone charges. It mentions and requires the deregulation of bus fares and the adjustment of power tariffs, gas prices charged to domestic household consumers, water and sewerage tariffs, taxes, fees, and user charges for roads, rail, ports, and aviation. There are dozens of very precise clinical interventions that a Structural Adjustment Programme is meant to undertake. Appendix 17.1 in the current edition, gives details of the most recent Poverty Reduction Growth Fund agreed to between the Government of Pakistan and the IMF, which ran through the period December 2001 to December 2004.[8]

Given the extensive details, one might lose sight of the larger issues and objectives of the 1988 programme. The programme was supposed to improve financial internal and external balances, increase average savings rates—particularly in the public and government sectors—and promote and encourage private sector investment and activity. In particular, the key objectives of the 1988 Structural Adjustment Programme over the three-year period, with their annual targets were as follows:

a) Reduce the overall budgetary deficit to 6.5 per cent of the GDP in 1988–9, to 5.5 per cent in 1989–90, and further to 4.8 per cent in 1990–1, a level that is sustainable over the medium term;
b) contain the rate of inflation to 10 per cent in 1988–9 and reduce it gradually to 7 per cent in 1989–90 and to 6.5 per cent in 1990–1;
c) reduce the external current account deficit to 3.4 per cent of GDP in 1988–9, and further to 2.8 per cent in 1989–90 and 2.6 per cent in 1990–1, a level judged sustainable over the longer term;
d) reduce the civilian external debt-service ratio from 27–28 per cent in 1986–8 to the sustainable level of less than 22 per cent by 1990–1;
e) increase gross official foreign exchange reserves from the equivalent of about three weeks of merchandise imports at end-1987–8 to a safer level of about seven weeks of imports by 1990–1;
f) contain the growth of domestic credit and money supply in line with the growth of nominal GDP at the target rate of inflation, with sufficient allowance for the desired increase in net foreign assets; and
g) consistent with the macroeconomic adjustments, sustain real GDP growth at about 5.2 per cent in 1988–9 and at 5.5 per cent in 1989–91.[9]

There are three key areas under which the reforms detailed in Appendix 15.1 in the first edition were to take place: fiscal policy, foreign trade policy, and the financial sector. Since these three broad areas were meant to help determine the impact on, say, agriculture, energy, or even transportation, a little more detail of how the IMF and World Bank wanted to achieve their objectives, is warranted.

Appendix 17.1 in the current edition which gives some details of the later PRGF agreement also highlights similar sectors and shows that the general direction of the programme continues. One significant difference in the older programmes and the most recent one is the extent of *monitoring and data requirements* by the IMF from the Government of Pakistan, on key indicators. In many cases the Pakistan government and the State Bank of Pakistan, were required to submit data for scrutiny to the IMF *every week*!

17.2.1 Fiscal Policy

With an attempt to decrease the fiscal deficit/GDP ratio in three years from 8 per cent to 4.8 per cent, major emphasis was placed on resource mobilization, with major tax measures that were intended to increase the tax revenue elasticity. The purpose here was to raise the total revenue/GDP ratio from 17.6 per cent in 1988 to 20 per cent by 1991/2. The salient features of the tax effort included the gradual extension of the sales tax on imports and domestically produced goods, such that a general sales tax (GST) could have been implemented by the end of the three-year programme. The income tax system was also to be restructured so that there was greater vertical equity. To increase revenues, steps were outlined to increase prices and user charges for utilities such as electricity, natural gas, and water. The programme also suggested increases in the charges for higher education and health. While these attempts at raising revenue were identified, it was also decided to take measures that would strengthen the tax administration and implementation of these reforms.

Excessive government expenditure, particularly current expenditure, was also to be reduced from 26.2 per cent of GDP to 24.8 per cent in the three-year programme. This was to be achieved by reducing the growth of current expenditures, as well as by lowering and eliminating subsidies on fertilizers and revising the procurement prices of wheat. At the same time, since emphasis had also been placed on providing and increasing funds to the social sector, the Structural Adjustment Programme of 1988 envisaged an increase of 0.4 per cent of GDP (from 7 to 7.4) for development expenditure. There was also a major attempt to tighten the control over provincial expenditures, with a new federal/

provincial revenue-sharing agreement being worked out so that provincial government would make greater efforts to raise revenues.

17.2.2 Trade

Significant reforms were earmarked for the trade sector, where it was hoped that all the non-tariff barriers would be replaced by tariffs. At the same time it was planned to reduce the number of banned commodities from 400 to about 80, leaving only those that were banned for religious and security reasons, or under reciprocal or international agreements. In essence, this step would have allowed the import of a very large number of items that were previously banned. While non-tariff barriers were to be reduced, there was also to be a drastic reduction in the maximum tariff rate to 125 per cent in 1989/90 and to 100 per cent at the end of the three-year programme. Tariffs were to be imposed on a discriminatory basis depending on the degree and stage of processing. Most tariff exemptions and concessions were to be removed, streamlining the entire tariff structure on imports. It is clear that the emphasis of the Structural Adjustment Programme of 1988, in the trade sector, was on extensively reducing tariffs so that imports could be made cheaper. However, there was also an attempt to increase exports, particularly higher-valued exports. In addition, with deregulation and privatization being promoted, the private sector was to be permitted greater involvement in the export of rice and cotton, both of which were previously solely under government control. In the latest agreement, the PRGF of 2001, these policies have continued, deepening the reforms further—see Appendix 17.1.

17.2.3 Financial Sector

With the opening up of the economy, as controls were removed, the financial sector was expected to play an important role in allocating resources, and in providing guidelines for other macroeconomic targets. The 1988 Structural Adjustment Programme highlighted measures to improve the efficiency and profitability of the banking system and to increase the autonomy and accountability of public sector financial institutions, particularly the nationalized commercial banks. Attempts were made in the programme to tighten prudential regulations and the supervision of the banking system. Debt recovery had been woefully inadequate in the past, and it was recognized in the Structural Adjustment Programme document that the legal framework for debt recovery needed to be strengthened. Since state-controlled nationalized banks had been very dependent on state patronage, attempts were also made to increase the banks' own capital resources. The programme also proposed the establishment of a credit information bureau within the State Bank, allowing access to the private sector about priority areas. On the monetary policy side, policies were to be undertaken to abolish negative real interest rates on concessional credit programmes, and efforts were to be made to free interest rates in the market for medium- and long-term credit, making the interest rate more responsive to market conditions rather than being under the control of the government. Directed credit schemes, which have been used extensively by the government to suit its needs, were to be limited under the proposals in the 1988 Structural Adjustment Programme. It was believed that the deregulation of controls in the banking sector would provide competition, which would then allow the establishment of private banks unencumbered by government controls and priorities. Capital markets were also to be encouraged to act as another source of capital/credit for firms. In this regard, the government was expected to promote private venture capital firms and eliminate the official setting of share prices.

In addition to these steps, the 1988 Structural Adjustment Programme proposed policies in the monetary sector, where the government was expected to pursue cautious domestic credit policies so that inflationary pressures were curtailed and perceived improvements in the balance of payments were not jeopardized. Monetary expansion was to be kept in line with nominal GDP growth. Appendix 17.1 shows that the general direction of these 'reforms' has been very similar all through the 1990s, well into the current 2001–04 programme, (also see Chapters 14 and 15 for an extensive review of these reforms).

17.3 Was the 1988 Structural Adjustment Programme a Success? Achievements and Failures

One can determine the success or failure of a programme in conventional terms by identifying programme targets and then examining whether those targets were met. This method implies that there was sufficient information, knowledge, and understanding at the time the original targets and objectives were set, to highlight the problem areas and their possible solutions. If the problems were identified correctly and the programmes target them, we can determine success or failure by the extent and degree of the deviation from their given targets. This is the methodology adopted by the IMF/World Bank, believing that its original framework, the identification of issues, and the priority attached to them were correct. In this section we reproduce and summarize the assessment of the 1988 Structural Adjustment Programme by the donors themselves. In Section 17.6 we question the entire basis of the Structural Adjustment Programme with respect to Pakistan.[10]

The Structural Adjustment Programme was expected to maintain a strong growth performance over the three-year period, of above 5.5 per cent GDP growth each year, relying mainly on increasing investment and improving efficiency in investment. The deregulation of the economy, increased competition from liberalized imports, the adjustment in administered prices, along with substantially better fiscal effort were all cornerstones of the 1988 programme. A summary of the extent of the reforms actually implemented is presented as follows.

17.3.1 Fiscal Policy

The implementation of the adjustment programme as evaluated by the IMF/World Bank was weakest in the implementation of fiscal policy. Most quantitative targets were not met (see Table 17.3). Tax revenues as a percentage of GDP remained stagnant. On the taxation front, the following steps were taken: numerous income and wealth tax exemptions were eliminated; there was a simplification and rationalization of the tax structure; major steps to improve tax administration were attempted; despite a general sales tax, the number of taxpayers and sectoral coverage was low, with over 121 commodity categories exempt from the GST; the maximum duty rate for imports was reduced from 225 per cent in 1988 to 90 per cent in 1992; progress in reducing exemptions and tax concessions was somewhat limited; and revenues from trade taxes declined from 5.9 per cent of GDP to 5.1 per cent. Furthermore, debt-GDP ratios failed to improve despite rapid growth in GDP, and external debt increased from 44 per cent to 46.5 per cent of GDP.

17.3.2 Trade and Balance of Payments

There was a stepwise reduction in maximum tariff rates and an elimination of many non-tariff barriers (see Table 17.4). Import licences were abolished except for products that were prohibited. Improved incentives for exports were given, but it was also observed that trade liberalization encouraged the

Table 17.3
Summary of Public Finance:[a] 1988/9 to 1990/1 (% of GDP)

Item	1987/8 actual	1988/9 actual	1989/90 actual	1990/1 actual	SAP target
Total revenues	18.4	18.9	19.5	16.5	20.8
Tax and non-tax revenues	17.3	18.1	18.5	15.5	19.7
Tax revenues	13.8	14.3	13.9	12.8	14.9
Direct	1.8	1.9	1.8	2.0	2.4
Indirect	12.0	12.4	12.1	10.8	12.5
Domestic	5.8	6.4	5.7	5.3	6.6
Excise	2.6	2.6	2.7	2.5	2.8
Sales tax	1.3	1.9	1.8	1.7	2.1
Surcharges	1.9	1.9	1.1	1.2	1.8
Custom duties	5.6	5.5	5.9	4.9	5.4
Import duties	5.1	4.9	5.3	4.5	5.0
Export duties	0.5	0.6	0.6	0.4	0.4
Others[b]	0.6	0.5	0.5	0.5	0.5
Non-tax revenues	3.5	3.7	4.6	2.7	4.8
Surplus autonomous bodies	1.1	0.9	1.0	1.0	1.1
Total expenditures	26.9	26.6	26.1	25.2	25.6
Current	20.1	20.4	19.5	18.7	18.8
Federal	15.7	16.2	15.3	14.7	14.7
Defence	7.0	6.6	6.9	6.4	6.1
Interest payments	4.7	4.7	5.3	4.2	5.4
Subsidies	1.0	1.6	1.0	0.9	0.7
Other[c]	3.1	3.2	2.2	3.2	2.5
Provincial	4.4	4.2	4.2	4.0	4.1
Development	6.8	6.3	6.6	6.5	6.8
Deficit	–8.5	–7.7	–6.5	–8.7	–4.8
Deficit financing	8.5	7.7	6.5	8.7	4.8
External resources (net)	1.9	2.4	2.7	2.5	1.9
Domestic non-bank financing	4.6	4.9	4.5	2.0	2.5
Domestic bank financing	2.1	0.4	0.4	4.2	0.4
Borrowing outside budget	0.0	0.0	0.0	0.0	0.0
For memorandum					
Public savings	–1.7	–1.4	0.1	–2.3	2.0
Primary balance	–3.8	–3.0	–1.2	–4.5	0.6

[a]Of the federal and provincial governments and certain autonomous bodies (WAPDA, OGDC, PTC, NHA, PTV, and NFCP).
[b]Including additional revenue measures to be implemented in 1992/3.
[c]Includes unidentified expenditures.
Source: World Bank, *Pakistan: Country Economic Memorandum FY93*, Report No. 11590–Pak (Washington: World Bank, 1993), 14.

Table 17.4
Changes in Trade Policy: 1987/8 to 1992/3: Non-Tariff Barriers

Year	Items removed from[a] Negative List	Items removed from[a] Restricted List	Maximum[b] tarriff (%)	Import surcharges (%)	Iqra surcharge (%)	Licence fee (%)
1987/8	136	10	225	5	5	4
1988/9	169	51	125	6	5	5
1989/90	70	20	125	7	5	5
1990/1	97	43	95	10	5	6
1991/2	23	17	90	10	5	6
	21	11	90	0	5	6

[a]Items removed are a mixture of numbers and categories and therefore are only a broad indication.
[b]Automobiles and alcohol continue to carry tariffs up to 425%.
Source: World Bank, *Pakistan: Country Economic Memorandum FY93*, Report No. 11590–Pak (Washington: World Bank, 1993), 20.

import of goods and services. Exports increased sharply by 11.6 per cent per annum in US dollar terms, and by 14.4 per cent by volume, mainly due to increased exports in cotton manufactured products, synthetic textiles, leather products, sports goods and other non-traditional manufactured goods; and the trade balance improved significantly from –6.6 per cent of GDP to –4.6 per cent. There was deterioration in the services balance (from –3.6 per cent of GDP to –4.6), and a sharp decline in workers' remittances. Large foreign exchange inflows due to liberalization of foreign currency deposits took place, increasing by US$1.2 billion (2.4 per cent of GDP); the current account deficit declined. Gross external reserves increased due to large private capital inflows into foreign currency deposits. There were noticeable increases in foreign direct and foreign portfolio investment.

17.3.3 Financial Sector

Resident Pakistanis were allowed to operate foreign currency accounts which in 1998 turned out to be a complete disaster having very serious consequences—see Chapter 18. Banking procedures were liberalized and banks were authorized to increase interest rates on these deposits above LIBOR. Two state-owned banks, Muslim Commercial Bank and Allied Bank Limited, were sold to the private sector. Ten new private sector commercial banks as well as eight new investment banks were sanctioned. In the *stock market*, there was a liberalization of regulations for domestic and foreign investment generally, and foreign portfolio investment in particular, resulting in increased activity and capitalization in the stock market; and a liberalization of rules regarding the pricing of new issues. In the *monetary sector*, a full-fledged auction of government debt was initiated; the rate of return on six-month Treasury Bills rose gradually from 6 per cent to 13 per cent; rates of return on concessionary lending schemes increased so as to remove the negative real interest rate in this area; bank deposits increased; and there was a gradual narrowing of interest rate differentials between various financial instruments. Credit ceilings for individual banks were replaced by credit–deposit ratios: 35 per cent credit to the private sector was permissible on rupee deposits, and 40 per cent on foreign currency deposits.

17.3.4 Liberalization and Privatization

A forceful programme for liberalizing the economy from government control was undertaken. The sanctioning of private investment and import licensing was abolished. Other regulatory restrictions, including registration of technical and foreign loan agreements, and procedures for employment of foreign workers were also abolished. Areas where previously only the government sector could invest, such as power generation, commercial and investment banking, and air and sea transport were opened to the private sector. One-hundred-and-five manufacturing units were put up for privatization. By November 1992, sixty-seven had been sold, with further steps taken to privatize the telecommunication and gas sectors.

17.3.5 Other Areas

Performance of the agricultural sector improved significantly during the programme. Cotton, due to improved technology and attractive incentives grew markedly, at 10.2 per cent per annum in volume terms. The performance of other sectors in the agricultural sector was not particularly strong. Subsidies on pesticides, seeds, and agricultural machinery were eliminated. Formal control over the price of urea was lifted, and prices of phosphatic and potash fertilizers were adjusted upwards.

Industrial value added grew by 6.3 per cent during the Structural Adjustment Programme of 1988. Large investments were undertaken in all major energy sources. Cotton industries dominated, with output of cotton yarn increasing at an average annual rate of 15 per cent.

Private sector gross fixed capital formation expanded from 7.7 per cent to 9.4 per cent of GDP. Domestic savings grew from 10.5 per cent to 12.5 per cent of GDP. There was a sharp rise in savings held overseas by Pakistanis, which were then transferred and deposited in foreign currency deposits in the domestic banking sector.

Energy prices increased by an average of 4 per cent in real terms. Telephone calls were subject to excise duty, earning substantial revenue.

17.4 The World Bank/IMF's Overall Evaluation of the 1988 Structural Adjustment Programme

The above sections have presented a list of reforms and targets that the 1988 Structural Adjustment Programme hoped to achieve. As we have seen, the Government of Pakistan has implemented a large number of reforms in different sectors of the economy. Table 17.5 presents a detailed summary list of the key indicators and programme targets for the Structural Adjustment Programme of 1988.

The World Bank's own opinion about the programme is as follows:

> while performance during the adjustment period has been strong in GDP and export growth and in structural reforms to encourage private sector economic activity, it has been weaker in achieving a sustained reduction in the fiscal deficit and in improving external sector balances. The financial imbalances, especially persistently large fiscal deficits, raise concern about their potential adverse effects on growth performance. Similar concerns are also raised by the lack of significant improvement in poverty and social sector indicators.[11]

Table 17.5
Summary Key Indicators and Programme Targets: 1987/8 to 1991/2

Item	1987/8	1988/9	1989/90	Provisional 1990/1	Preliminary 1991/2
Growth and savings indicators					
GDP (market price – growth rate)	7.6	5.0	4.5	5.5	7.8
GDI/GDP	18.0	19.0	18.9	18.7	18.7
of which:					
Private GFCF	7.7	8.3	8.9	8.9	9.4
Public GFCF[a]	8.8	9.0	8.3	8.2	7.7
GDS/GDP	10.5	11.6	11.7	12.4	12.2
GNS/GNP	13.6	14.1	14.2	14.3	15.7
Inflation indicators					
CPI (% change)	6.3	10.4	6.1	12.7	9.6
Fiscal indicators					
Total revenue/GDP	18.4	19.0	19.5	16.5	19.4
Tax revenue/GDP	13.8	14.4	13.9	12.8	13.7
Public savings/GDP	–1.7	–1.4	0.1	–2.3	–0.3
Overall balance/GDP	–8.5	–7.7	–6.5	–8.7	–7.5
Bank financing/GDP	20	0.4	0.4	4.2	
Competitiveness indicators					
REER (% change)	–	–1.8	–8.2	–2.3	–2.7
Merchandise exports (growth in US$)	24.7	6.2	6.3	19.8	16.6
External indicators					
Current account[b]/GDP	–4.4	–4.8	–4.7	–4.3	–3.1
Gross external reserves (weeks of imports)	3.0	3.0	4.0	3.3	5.6
Total public debt[c]/GDP	44.4	47.4	49.4	45.5	46.5
Public debt service ratio[d]	26.9	24.0	24.5	21.5	22.5

GDI = Gross Domestic Investment
GFCF = Gross Fixed Capital Formations
GDS = Gross Domestic Savings
GNS = Gross National Savings
REER = Real Effective Exchange Rate
[a]Based on a wider coverage than the fiscal accounts
[b]Net of official transfers
[c]Includes deposit liabilities of the banking system but excludes military debt
[d]Includes debt service payments of medium- to long-term debt and interest payments on short-term guaranteed debt and deposit liabilities of the banking system. As a percentage of exports of goods and services and remittances.
Source: World Bank, *Pakistan: Country Economic Memorandum FY93*, Report No. 11590–Pak, Washington, 1993, 35.

These conclusions, however, seem somewhat at odds with the data available in Table 17.5. Four key indicators are believed to reflect the state of the economy: GDP growth rates, the budget deficit as a percentage of GDP, the current account deficit/GDP ratio, and the inflation rate. Thus, even though extensive reforms have taken place in most sectors, including trade, liberalization, and the financial sector, if the above four indicators do not show a significant improvement, it would be difficult to conclude that the programme has been a success. Let us re-examine the case for the 1988 Structural Adjustment Programme with respect to the key indicators identified above.

Based on Table 17.5, it seems that GDP growth, the World Bank claim notwithstanding, has managed just a 5.5 per cent annual increase at the end of the 1988 Structural Adjustment Programme. Gross domestic investment as a percentage of GDP, which was supposed to increase, has increased only marginally, mainly because public gross fixed capital formation has fallen. Gross domestic and gross national savings have, however, shown a substantial increase. Inflation, a key variable, is way off target in the final year of the programme, as are all fiscal indicators, a fact even acknowledged by the World Bank. The fourth key indicator, the current account deficit, is also substantially off target. Thus, three of the four indicators that would provide a summary position of the achievements of the Structural Adjustment Programme are *far from the targeted figures*. Clearly, on the conventional criteria laid down by the IMF and the World Bank, the 1988 Structural Adjustment Programme, despite all the propaganda and fanfare, *was not much of a success*.

The overall perception by the World Bank and IMF of their policies in Pakistan seems to be mixed. They feel that some positive developments had taken place, especially in the case of pricing policies, trade liberalization, export promotion and some public sector reform. Where governments had failed is in lowering the budget deficit to preferred levels, diversifying exports, cutting inflation, etc. William McCleary of the World Bank argued that in the mid to late 1980s, Pakistan experienced

> a period of rapid growth and inflows of migrant workers' remittances [which] had raised standards of living broadly across the population. Private investment played a leading role in this expansion, and no longer was public investment in large scale industry viewed as the engine of growth. . . . The economy became more outward looking, flexible and market oriented.[12]

He continued that 'reforms in Pakistan have been sustained because of the government's incremental and flexible approach and because continued strong economic performance has obviated the need for reversals'.[13] His overall view was that Pakistan's economy was doing well for itself, and then the IMF intervened, after which it did somewhat better for a few years. McCleary argued that, when Pakistan's economy was doing well, it was because the conditions imposed on Pakistan were being followed and because the Government of Pakistan was thinking like the IMF and the World Bank. He argues that the IMF/World Bank policies were sound and that when and if things went wrong, it was because of poor management on the part of the government.

William McCleary argues that the Fund and the Bank played a significant and positive role in the development of the economy during the 1980s. A leading exponent of Structural Adjustment Programmes, and a director at the IMF, Mohsin Khan, seems to disagree. Khan argues that

> although there have been some attempts at liberalization, the evidence is far too tenuous to argue, as McCleary does, that the economy has become more open and more outward oriented in the 1980s. . . . The changes that have been made have been marginal, and it is doubtful whether those made in the 1980s have been any greater than those of the previous decade.[14]

Recognizing that some targets had not been met—for example, the savings/investment balances were significantly lower than those targeted under the 1988 programme; large fiscal deficits persisted and were a source of financial instability; efforts at resource mobilization were not successful; the structure of government expenditures did not improve significantly; and the balance of payments, despite government reform, did not show particular progress—the IMF and World Bank came up with yet another extended Structural Adjustment Programme for Pakistan. This new Structural Adjustment Programme which began in 1993 initially for one year, and then subsequently ran from 1994 to 1997, had features that were quite similar in principle to the 1988 programme (see Appendix 15.2 in the first edition of this book). As a consequence, the Government of Pakistan based each of its policy decisions and managed the economy almost precisely according to the 1994 programme.

Much of the analysis by the World Bank and the IMF of its 1988 Structural Adjustment Programme has been done at a macro level, and they did not really look at many of the more critical micro issues. Now that Pakistan has undergone some extensive programmes, some Pakistani scholars have evaluated the impacts of the programmes at a somewhat disaggregated level.

Work undertaken by Shahrukh Rafi Khan, who has tested a number of hypotheses regarding the impact of the Structural Adjustment Programme as applied to Pakistan. His results show that, particularly on labour and the poor, the impact has been severe. The general sales tax and subsequent inflation hurt the poor, and cuts in government hiring in order to release pressure on government expenditure are likely to increase unemployment. The withdrawal of large subsidies also has similar deleterious consequences. For S. R. Khan, following the 1988 programme, 'the socioeconomic conditions of labour and the poor seem to have deteriorated'.[15]

Similar results have also been found by studies which show that poverty, after having decreased in the 1970s and 1980s, returned to Pakistan following the IMF programmes.—see Chapter 22. Low GDP growth, its sectoral distribution, lower employment and real wages, and fiscal policy designed to cut public expenditures and social development were seen as the key causes of a return to poverty in the 1990s. Similarly, A. R. Kemal found that unemployment increased,

as did poverty and income inequality, on account of the 1988 Structural Adjustment Programme.[16] The little research published on the impact of the Structural Adjustment Programme in Pakistan seems to support the general conclusions from studies from across the globe—also see Chapter 18, and Chapter 22 on Poverty.

The 1994–7 programme was halted by the second Benazir Bhutto government in 1995 (see Box 17.1), but her government was forced to go back some months later and agree to a standby loan, on stricter terms. The standby loan, too, was discontinued as the government failed to fulfil important conditions imposed by the IMF. After the dismissal of the second Benazir Bhutto government in November 1996, the second Nawaz Sharif government in March 1997 announced a large number of supply-side measures, such as cuts in income tax and a huge reduction in the maximum tariff rate from 65 to 45 per cent, with a reduction in tariff slabs. Although the government insisted that it was undertaking these measures 'on its own initiative', rather than on any advice or compulsion from the IMF, the measures seemed to be from an IMF manual, and were very well received by the IMF and World Bank. In October 1997, the Nawaz Sharif government signed yet another agreement with the IMF, the first in some years by an elected government. This third major agreement since 1988, worth US$1.6 billion, was composed of an Extended Fund Facility (EFF) and an Enhanced Structured Adjustment Facility (ESAF). However, as Panel B in Table 17.2 shows, there have been as many starts as stops to all there programmes. The Musharraf government continued the tradition of taking loans from the IMF and became the first government to complete a programme in its entirety. It is clear that the IMF and the World Bank will continue to influence government economic policy in Pakistan for some time to come.

17.5 The 2008 Stand-By Agreement

As we show in the preceding sections, throughout the 1990s, Pakistan was known as a one-tranche country, where agreements signed between the IMF and the (many) governments of Pakistan, were often reneged upon or cancelled by the Government of Pakistan, usually after receiving the first, or a couple of tranches, of the many programmes agreed to. It was only in 2000/01, when the first full programme, a Stand-By Arrangement of ten months worth $495 mn, was completed. Subsequently, in 2001, another agreement, a Poverty Reduction and Growth Faculty (PRGF) arrangement of $1.3 bn, was agreed to and also completed in 2004, this time even prior to the end-of-

Box 17.1

The IMF Shows its Displeasure

Attempts by Pakistan's government to show independence were not received well by the IMF.

It was in September 1993 that Moeen Qureshi's caretaker government signed a stand-by agreement with the IMF, and this served as a precursor to the very large agreement signed later by the Benazir Bhutto government. Things went rather well for the first two years of the programme where, while targets went unmet, the general direction and pace of the so called 'reforms' seemed acceptable to the IMF. The fiscal deficit was brought down substantially, as were tariffs, but again not by as much as the IMF had wanted. The deregulation, liberalisation, and privatization agendas set by the IMF were also closely followed, and frequently renegotiated when any hitch seemed to occur. Pakistan, in fact, was cited as a very good example of a country successfully following the structural adjustment programmes devised by the IMF.

But then came the 1995–6 budget in June last year. Analysts, economists, and businessmen were surprised by the fact that the government had, very unexpectedly, offered a mild budget far removed from the very strict one that was widely anticipated. The tariff rate, for example, was cut by only five per cent, and not twenty as was expected, reducing the maximum tariff rate to 65 per cent. New taxes to the tune of only 16.3 million rupees were announced, and the target for the budget deficit was set at five per cent of GDP. The IMF, for its part, had insisted on a 4.5 per cent target.

All in all, the 1995–6 budget was perceived to be pro-industry and growth enhancing, encouraging the belief that a number of the targets would be met for a change. Most of all, many analysts perceived the budget to represent the interests of Pakistan, rather than the demands of the IMF.

The IMF was not at all pleased with this attempt by the government to assert its independence, and the Fund froze the remaining tranche of the ESAF [Extended Structural Adjustment Facility] in its last year of operation. It took less than four months, however, for the government to make a quick U-turn. It imposed more taxes, devalued the rupee, promised the IMF that it would agree to its earlier conditions and begged the Fund to resume the aborted ESAF. Between October and December 1995, top officials of the Government of Pakistan made numerous trips to Washington trying to appease the IMF and to convince it of the sincerity of their intentions in carrying out the rest of the programme. IMF officials also visited Islamabad and finally, towards the end of last year, yet another agreement was signed.

The government immediately claimed victory and informed the public that the IMF, by agreeing to the new loan, had endorsed the policies of the Benazir Bhutto government and had confirmed that the economy was doing well enough to warrant a loan from the Fund.

Moral of the tale: the government simply cannot defy the IMF. And for that, it has only itself to blame.

Source: Zaidi, S. Akbar, *The Herald*, March 1996.

programme date. In a triumphant gesture, the incumbent government of General Musharraf swore never to return to the IMF again, and proposed to continue the reform process on its own.

After numerous political and economic changes in the period 2004–08, the new PPP government in 2008 decided to return to the IMF for a $7.6 bn Stand-By Arrangement, which was increased in 2009 to $11.3 bn. The Stand-By Arrangement was to come to an end in December 2010, but the Government of Pakistan, in December 2010, requested that the Fund extend the Programme till September 2011, which meant that the final tranches to have been made available in September 2010 following some far-reaching taxation proposals, were withheld. The Government of Pakistan had agreed to impose a Value Added Tax by July 2010 which would have meant the release of the two final tranches and the conclusion of the third consecutive programme. The inability of the Government to impose a VAT-like Reformed General Sales Tax (RGST), led to this extension and the Government subsequently promised to impose the RGST by July 2011, but once again reneged on its promise, resulting in the IMF aborting the loan in late 2011.

It was not just that the VAT was not imposed by July 2010 as originally agreed, but other performance criteria related to the State Bank of Pakistan borrowing and on the overall fiscal deficit, were also breached. It was clear in July 2010 that the Pakistan People's Party government would need to renegotiate its agreement with the IMF. However, in July and August of 2010, the worst floods in Pakistan's history affected close to 12 per cent of Pakistan's population, greatly affecting the economy broadly, but particularly affecting agricultural crops and infrastructure in many parts of the country. It was very clear that while the damage to the economy was quite severe—however, not as severe as the Prime Minister Yousaf Raza Gilani had stated, damaging as much as 25 per cent of the GDP—resettlement, emergency assistance, and reconstruction, would all impose a heavy burden on an economy which was already coming to terms with the consequences of militancy and terrorism at a time when there was also a global slowdown. The floods made matters far worse and led to a sympathetic hearing on the part of the IMF, where the imposition of the RGST was postponed and short-term concessions were made to specific budget deficit targets, all eventually resulting in the extension of the Stand-By Arrangement.

While this extension gave the Government of Pakistan far greater breathing space than it could have hoped for, it also highlighted numerous problems which the government had been unable to address and highlighted structural weaknesses in Pakistan's political economy. It has to be recognized that Pakistan was at that time a weak, although emerging, democracy, which returned to electoral politics after nine years of military rule and praetorian democracy, only as recently as 2008. The incumbent government had been part of a coalition government since March 2008, and had to deal with numerous political, constitutional, and economic problems, many of a very serious nature. The government deserves credit for legislating on a number of critical areas despite being in a coalition. However, key issues, such as taxation (particularly the RGST) were not supported by coalition partners, and always faced a difficult passage in Parliament. Things were made far worse when two of the coalition partners of the Government withdrew their support and Pakistan's government became a minority government, in power largely because the main opposition party in Parliament decided not to play dirty politics and remain a friendly opposition. All along, it looked even less likely that the RGST would be approved by Parliament, with only the minority government supporting it. It was the enforcement of this RGST which was the main requirement of the Stand-By Arrangement.

The inability to impose the RGST reflects a larger problem in Pakistan's economy which affects the fiscal deficit, and that is the tax-to-GDP ratio and overall resource generation by various governments, issues which were discussed in detail in Chapter 10. Pakistan's tax-to-GDP ratio is less than 9 per cent of GDP, and the fiscal deficit at that time, was around 4.7 per cent of GDP. The perennial inability and unwillingness by all governments to raise revenue, has affected much in the economy of Pakistan. The already limited Public Sector Development Programme (the annual development expenditure) for 2010/11 announced in June 2010, was drastically cut following the floods in July 2010 soon after the start of the fiscal year. With a large part of the PSDP directed towards flood relief, there was little left for development. This problem arose primarily because government revenues were too few and because of large scale expenditures which many considered wasteful. At that time, there were reported to be 73 ministers and advisors to the Federal Government alone, and less than 2 per cent of Pakistan's population paid any income tax, in a country which has a mobile phone teledensity of 70 per cent. Rough estimates suggest that only one-third of the taxable population pay income tax, with the other two-thirds either exempt for some reason or the other, or choosing not to file their tax returns. The RGST was an attempt, which many economists considered to be highly unfair and unjust because it was an indirect tax and with so much tax avoidance, to raise revenue—also see Boxes 17.2 and 17.3.

Moreover, government borrowing from the central bank continued to grow at a time when the interest rate had also been raised to curb inflation, which had been in double digits for almost three years. On account of political and economic problems at home—energy shortfalls had been marked since 2009—all growth indicators were lowered. The GDP growth rate originally set at 4.5 per cent for the fiscal year 2010/11, was reduced to 2.5 per cent, with lower agricultural and manufacturing output trends.

Some economists feared that these conditions may have led to the central bank having to print even more money and eventually to hyperinflation. One must remember, that Pakistan has had even higher deficits in the past, although this created a serious debt crisis in the 1990s. Unfortunately, there never was any clear focus or plan as to how the government intended to address the revenue shortfall problem or the fiscal deficit issue at a time in 2011, when the IMF was pressing upon the government to continue with the agreed SBA. A weakening position in Parliament at that time and growing uncertainty in the political arena

Almost every expert has pleaded that for wasting borrowed money, the fault lies with Pakistan's ruling classes and not with the IMF or the World Bank. Had these conditions been implemented, Pakistan could have improved its financial governance, but funds were ruthlessly squandered by the elite. On the one hand, this nation has become heavily indebted and on the other, all systems have been further destroyed with unabated corruption, inefficiency, and incompetency.

During the Musharraf-Shaukat era, economic managers were constantly telling lies to the nation that the begging bowl had been broken and all ties with IMF and other foreign donors were severed, whereas in reality, new loans for reforming tax, banking, and the justice systems—just to mention a few—were negotiated with unprecedented vigour. The democratically-elected government of the PPP also decided to follow the same path. Their justification was that with the IMF loan, financial discipline and transparency would come—the result after over three years is diametrically opposite. It is a shameful attitude of our rulers that they are not ready to live within their means, and are dependent on the IMF and the World Bank even for the purpose of bringing transparency and fiscal discipline.

The experts, pleading for more taxes, also ignore the fact that real problems are: the non-taxation of the rich and wasteful spending by the rulers. Under the existing inequitable system, the burden of taxes is less on the rich and more on the poor. Taxes, in the nature of full and final discharge of liability, are withheld even from those who have incomes below the taxable threshold. These taxes cannot be termed an 'income tax'. These are transaction taxes or taxes on consumption. Being regressive in nature, such levies take a large portion of the income of the poor and a negligible part of the hefty income of the rich. These taxes make the rich richer, and the poor poorer.

Source: This is a short, edited, excerpt from: Bukhari, Huzaima and Haq, Ikramul, 'Sorry IMF, we are incorrigible', *Business Recorder*, Karachi, 19 August 2011.

a brief history of Pakistan's dependence on 'external forces' and on programmes and policies exported from abroad. This section also makes the strong case that perhaps Pakistan did not really need an IMF-sponsored Structural Adjustment Programme, in the 1990s—or even later in 2008 or 2012/13—see Box 17.6, and that the economic and structural conditions that existed prior to the 1988 programme did not really warrant such a programme. This section then tries to answer the perplexing question why, if the Structural Adjustment Programme was not really essential, was it accepted in the first place—Also see Chapter 25 on the political economy of aid to Pakistan, which shows who actually benefits from aid given to Pakistan.

17.6.1 Pakistan's Dependence on Washington, or are Governments Autonomous?

To state that governments, particularly in underdeveloped countries, are dependent on and pressurized by events, factors, agencies, and institutions outside the realm of the government itself, is to state the obvious. Governments are affected by happenings within their own geographical domain, as well as by factors determined by outside interests many thousands of miles away. Foreign patronage of Third World governments has often been the norm, where local and indigenous sensitivities have been trampled upon and ignored by governments whose existence has depended on approval from abroad. The 1960s, 1970s, and 1980s, with the likes of Pinochet, Somoza, the Shah of Iran, Zia, and Marcos, provide ample proof that most governments in the Third World were imposed by, and dependent on, 'external influences'. And to be fair, nor was Washington responsible for this alone: puppets of the now extinct Soviet empire were also ruling their own countries with a severity that wrecked their societies.

Pakistan must count itself lucky to be amongst those countries in the world that have always supported the Washington consensus, whatever that may happen to be at a particular time. An examination of the political processes from the early years of Pakistan's existence shows that numerous important political and governmental decisions were influenced, if not directed, by the relationship with Washington. Events after 11 September 2001, and after the US led war occupation of Iraq and Afghanistan, have shown Pakistan's complete subservience to US interests in the region. While Washington may not actually have manoeuvred the process of history as it has evolved in the political arena in Pakistan, it has had a serious influence, for geopolitical and other reasons, over the outcome of events. Subtle pressure and suggestive decisions have changed the course of history in Pakistan on more than one occasion, most recently, in September 2001—see Chapters 18 and 25.

As earlier chapters have shown, foreign aid, particularly from the US or sanctioned by it, has been one of the sources of its growth and development. In the early Ayub period, aid was considered to be an essential cause of the high rates of growth of the economy, and after 1979 aid, both bilateral and multilateral, provided large funds for the economy. From the time of the India–Pakistan war in 1965 until the Soviet invasion of Afghanistan, 'Pakistan remained in the United States' political disfavour'.[18] This meant that other multilateral agencies, too, were not enthusiastic about providing aid to Pakistan in this period. The first structural adjustment loan under the IMF Extended Fund Facility was made available to Pakistan in November 1980. Pakistan was advised to delink the rupee from the dollar, 'focus on efficient import substitution, reduce government expenditures, establish tax reforms to increase domestic resource mobilization, encourage savings, institute price reforms, and push for export-led growth' and privatization'.[19] The Zia regime, unlike those that have followed it, was selective in its choice of policy options: the rupee was delinked and devalued

Box 17.6

How Important is the IMF Assistance for Pakistan?

Once the IMF had agreed to give Pakistan assistance of $7.6 bn assistance to be disbursed over 23 months, some economists questioned why it was necessary to make use of this support, albeit they questioned some of the official justification of the loan and the manner in which policy was to be implemented.

Pakistan is in a dire need of foreign financial assistance. There is a sharp depletion in its foreign exchange reserves. Rupee has depreciated 28 per cent. This is building enormous pressure on its public debt and reinforcing the inflationary trends. The manufacturing sector has recorded negative growth. The twin fiscal and trade deficits are presenting equally bleak picture.

While the economy came under stress, the policymakers have been making hectic efforts to explore all possible sources of aid. Finally they have succeeded in negotiating with the IMF a loan. Pakistan is its member and in the current situation it has the right to approach it while on the other hand it is also a mandatory obligation of this institution to assist its member countries. More recently it has come to the rescue of some other countries as well. Even in the past it has been assisting Pakistan on a number of occasions and on some occasions there were some adverse fall outs of its programmes for the economy, albeit debatable for its responsibility.

Debate is going on in the country on whether or not it is good to have the IMF loan. My effort in this paper is to present as an objective view of this assistance and to put forth suggestions to make the IMF assistance productive. It is quite normal for the IMF to attach some conditionalities with its loan and these often vary depending on the recipient country's specific situation. Its interest rate is often less than the market rate.

The conditionalities are in fact the reform measures which the IMF considers necessary to put the economy back on the track. These have already been negotiated in case of the said loan but so far these have not been exposed to the general public. Given our situation these could possibly be like the increase in bank discount rate, elimination of subsidies, reduction in budgetary deficit and BoP imbalance, improvements in human development indicators, liberalisation of trade, privatization, promotion of free enterprise, good governance, elimination of corruption, etc. Our long term development strategies of different perspective plans and budget documents stipulate similar reforms. So far there is no contradiction in perception. Moreover the country has already committed to these reforms as a member of the WTO. The problem is only of the time frame and their sequencing.

The economy is in the grip of recession which is likely to worsen if the global financial meltdown further accentuates. The recent fall in international oil and food prices has unleashed prospects for some respite and that may work on the supply side. But still there is a need for massive efforts to revive the domestic production, particularly in commodity sectors. The IMF support to be routed through the BoP, which would eventually help improve the investment level in the country. Scaling down the public sector development programme would reduce the aggregate demand. Cement industry and construction activities are often the first victim of it and this will be having its adverse impact on employment situation.

In the current situation the economy can not afford further pressure and it has to be first pulled out of the turmoil. In recession, further tightening on the demand side either through higher interest rate or through more taxes would counter the salutary impact of the IMF assistance. The government has already reduced the volume of subsidies on its own. Now its further reduction would forestall the healthy impact of a fall in international oil prices on the cost side. There should be no mad rush for privatization to avoid any possible loss in the sale of national assets. Its possible fall out for poverty has also to be kept in view.

There is no denying the fact that the economy is confronted with numerous structural problems but all can not be tackled at a time lest the system further derails. The country is in a state of war as the president has rightly stated in his address to the UN general assembly. This is itself a great challenge. To manage a weak economy in such a situation is a terribly difficult task. Moreover the leading coalition partner in the government is by its tradition considered pro-poor. The IMF assistance should not sabotage its programme.

The IMF has committed $7.6 billion assistance to be disbursed over 23 months. The country immediately needs more than this amount to replete its forex reserves at a level required to ensure stability in rupee exchange rate, not withstanding its massive requirements for building dams, and expanding its social and physical infrastructure. Despite being not too big amount this does carry a great symbolic importance in a holistic sense. This will improve the country's ratings in the international financial market. Other multilateral and bilateral donors give tremendous weight to the IMF's assessment. Likewise would be the attitude of the newly formed forum, the Friends of Democratic Pakistan.

At the close of the 1990s, Pakistan, in consultation with its donors, launched the structural adjustment and stabilization (SAS) programme which was a broad based effort to reform the whole economic edifice. Over the last almost two decades its implementation has continued. While it was half way through, it was recognized that some goals have been partially achieved but the side effects appeared in slowing down the growth tempo and increase in poverty. The major flaw lays in time sequencing of the reforms measures. For example imports duties, the largest revenue spinner, were hugely slashed but the resultant loss could not be made up through consumption based taxes. Partial success on fiscal side was achieved entirely due to reduction in government expenditure as a proportion of GDP. That took a heavy toll on budgetary allocations for social sectors like education and health. This has fed the scepticism about the current IMF assistance.

Perhaps the greatest drawback of our policy formulation is that we don't develop a consensus through a public debate. Therefore the ownership of the IMF programmes rests temporarily with the government in time. Some time policies and programmes fail because their pros and cons are not fully thrashed out. Once a programme is being negotiated with the IMF, then it is the responsibility of the national authorities to take all the stake holders into confidence. Simply to say that it is 'home grown' hardly enhances its credibility. The IMF has no logistics to defend each programme in recipient member countries.

Ahmad, Mushtaq, 'How important is the IMF assistance for Pakistan?', *The News*, Karachi, 24 November 2008.

against the US dollar, farmgate prices were raised, and some import liberalization took place. To attract capital, a general assurance was also given to the private sector. On the other fronts, the government was not particularly pushed to reform immediately. As Nabi and Hamid[20] argue, Zia was in a position to, and did, resist external pressure from the IMF and World Bank: 'when the government can clearly see the value of particular economic policy changes, it is willing to implement reforms. . . . Reforms that adversely affect established interest groups or have broad negative political consequences are generally not undertaken despite external pressure.'[21] In more recent times, it seems that governments are willing to do anything to adhere to the Washington consensus as events in Pakistan since September 2001 highlight (see below, and Box 17.7).

17.6.2 Did Pakistan Need to Go to the IMF in the 1990s?

The general proposition put forward by the Fund/Bank staff in order to convince governments that they ought to apply for structural adjustment loans is that their countries are in a bad economic state. They are told that there are major structural problems, the balance of payments is in critical deficit, the budget deficit is high, inflation is rampant, and the growth rate of the economy is too low and unsustainable in the long run.

We have shown repeatedly in previous chapters that the overall growth performance of Pakistan has been good, if not quite remarkable. Even when the first major Structural Adjustment Programme was started in the early 1980s, the main economic indicators showed very decent trends (see Table 17.6). Even after the onslaught of the 1988 programme, the economy continued to do quite well. Estimates show that GDP grew by 5 per cent during 1988–90, while in 1991/2 it grew by as much as 7.7 per cent. The growth rate in new (officially accounted) private investment had been in excess of 20 per cent per annum since 1988, and was as high as 30 per cent in 1991/2. Exports, meanwhile, grew by 20 per cent in 1990/1 compared to the previous year, and by 15 per cent in 1991/2. All these indicators very strongly suggest that there had been impressive growth, money was being generated and even the recorded official economy (not counting the buoyant unofficial economy) had shown signs of immense prosperity. Since the mid-1970s, the trend has been upwards, and most important indicators showed very healthy and positive signs even before the first Structural Adjustment Programme in 1980 (see Table 17.6).

It would therefore seem that Pakistan's economy was in fairly good shape when the Structural Adjustment Programmes were initiated, and while it could have been better, it had been functioning adequately without any so called assistance. A comparison with Bolivia, which agreed

Box 17.7

Aid Linked to Fulfilling IMF Commitment

The message from the World Bank's latest aid to Pakistan consortium meeting held in Paris on 23 and 24 April [1996] couldn't have been clearer: Islamabad will only get the $2.7 billion in fresh funds it wants and needs if the 1996–7 national budget to be published in June reflects the International Monetary Fund's prescriptions for structural reform. Any deviation from the path set out by the IMF, warned donors, would prompt a cutback in foreign aid.

The bank and other donors are looking for specific action on a number of fronts: the government is being asked to restructure expenditures, to continue restraint on defence spending, to use privatization proceeds to retire high-cost government debt and to take measures to broaden the tax base. Further trade reform is also viewed as a key aspect of the fiscal adjustment required.

A slowdown in implementing these reforms will mean less or perhaps even no aid. Unusually, the World Bank's final communiqué does not mention Pakistan's request for $2.7 billion in aid. And in fact, for the first time, donors have established a firm link between the government's implementation of the IMF programme and the amount of money that will be made available during the coming year.

Donors are learning from experience. A total of $2.2 billion was pledged in foreign aid at the meeting in Paris last year. But Pakistan's decision to slow the pace of key trade and tax reforms and the subsequent cancellation of the IMF's Enhanced Structural Adjustment Facility clearly jolted foreign governments. To make up for lost time, disbursement from donors in 1996–7 will be approximately $2.4 billion.

But not surprisingly, this time around foreign assistance is conditional on the contents of Pakistan's next budget and its implementation. 'The government's request for aid can be met if the policy reforms are adequate,' a World Bank official stressed. 'If we are satisfied with what we see in the budget, there will be support for Pakistan. It could be $2.7 billion or it could be less.'

Pakistan has told donors that it is working on a new Structural Adjustment Programme with the IMF, using the recent $600 million standby arrangement as a 'stepping stone' to secure the wider-ranging deal. It has also cautioned against 'exaggerated expectations' of how rapidly the fiscal changes can be accomplished.

'We are confident that the IMF agenda can be met,' V. A. Jafrey, the Prime Minister's Advisor on Finance, told *Dawn*. 'After last year's experience donors are making an explicit link. They are saying that if you do as planned, you will get the funds; if you deviate, the commitment might be lower. If the reform process is slowed, then there will be a reduction in commitment.'

'The key features donors will be looking for include a reduction in the overall budget deficit, tax reform, a lowering of import tariffs and an extension of the sales tax. They will also be looking at our development spending. Donors do not want the financial readjustment to be at the expense of the important social service programmes,' V. A. Jafrey said.

Source: *DAWN*, 25 April 1996.

Table 17.6
Growth Rates in Pakistan: 1980–2003

Year	GDP (1)	Budget deficit as % of GDP (2)	Private Investment (3)	Current account deficit as % of GDP (4)	Consumer Price Index (5)
1960s	6.8	–	20.9	–	3.8
1970s	4.8	–	17.0	–	12.3
1980s	6.5	7.0	15.0	3.7	7.3
1990/1	5.6	8.7	19.2	4.8	12.7
1991/2	7.7	7.5	30.3	2.8	10.6
1992/3	2.3	7.9	13.4	7.1	9.8
1993/4	4.5	5.9	11.6	3.8	11.3
1994/5	5.1	5.6	8.5	4.0	13.0
1995/6	6.6	6.5	18.7	7.2	10.8
1996/7	1.7	6.4	19.6	6.2	11.8
1997/8	3.5	7.7	13.3	3.1	7.8
1998/9	4.2	6.1	–11.4	4.1	5.7
1999/2000	3.9	5.4	14.3	1.6	3.6
2000/1	1.8	4.3	7.2	0.7	4.4
2001/2	3.1	4.3	17.3	+1.9	3.5
2002/3	5.1	3.7	9.2	+3.8	3.1

CAD = Current account deficit.
PBD = Primary budget deficit (budget deficit minus interest payments.
Source:Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various years).

to accept a wide-ranging orthodox stabilization programme in 1985, may highlight the extent of the differences in trends between the two countries. In 1985 Bolivia had an inflation rate of 11,000 per cent, a fiscal deficit in excess of 30 per cent of GDP, and a GDP per capita that was 20 per cent *less* than in 1980. Bolivia is an excellent example of a country which ought to qualify for an IMF/World Bank Structural Adjustment Programme. Numerous other countries, especially in Latin America, also suffered the fallout from the debt crisis and were forced to go to Washington. Pakistan did not need to go.

The arguments in this section rest on the assertion that Pakistan's economy, at the time of the initiation of the 1988 programme, was in relatively good shape and did not suffer from the problems faced by most African and Latin American countries, with rampant inflation, low or negative growth, large external debts, etc. Stabilization was usually meant for these countries, most of which were on 'the brink of economic crisis'.[22] Pakistan had never been in such a critical position though, ironically, may have gotten there *on account of following* these programmes. Furthermore, some of the outcomes and effects of Structural Adjustment Programmes that had affected other countries, have not taken place in Pakistan, but after following such 'reforms' things have gotten far worse, rather than better—see Chapters 18 and 22. The World Bank accepts that an 'investment lag' exists in countries following adjustment programmes, and that quite often investment shows *markedly negative* trends. In Pakistan this has not been the case, suggesting either that the adjustment programme had been particularly successful or, as we have argued, that the economy was strong enough to deal with such setbacks and did not need Fund-assisted programmes.

Finally, two interlinked issues need to be addressed. The IMF and World Bank agree that 'those countries that have done well on their economic agendas have had their own programmes *before* IMF or World Bank involvement.[23] Thailand and South Korea are two such cases where governments had devised their own programmes and implemented them, and only then went to the Fund. Pakistan also falls into this category: 'improvements in policies affecting stabilization and efficiency *had already begun to accelerate growth before the 1979 shock*, and policy reforms adopted since then helped to reconfirm the process'.[24]

Reforms take place due to *internal structural changes*, which begin to change economic, institutional, and political alliances and arrangements. The development of productive forces in the economy influence the political and social structure of that country. To accommodate such changes, reforms are made to alleviate the transition. There is a logic in this dialectic, in which the economy, politics, society, culture, etc. are consistently transforming themselves independently and each other collectively. In this chapter we argue that the structural changes that have facilitated growth, development, and the private sector in Pakistan have evolved out of this internal logic. See also Chapter 26, in which we argue that developments in the 1980s, with the emergence of a middle class, brought about changes in the economic structure of the country.

Even the IMF and World Bank accept the premise that their Structural Adjustment Programmes restructure a country's political economy. 'The implicit purpose of adjustment is to diminish the influence of some social sectors or interest groups whose political and economic control has blocked efficient use of a country's resources. At the same time,

adjustment programs stimulate the political and economic ascendance of other groups that can improve the country's competitiveness on international markets.'[25] Here we argue that these changes have also taken place in Pakistan, *without* adherence to an IMF/World Bank-sponsored Structural Adjustment Programme. A major purpose of the Structural Adjustment Programme is to create structural conditions that provide the impetus for enhanced growth. Institutional change, policies and politics take on a particular direction, and then certain specific programmes and policies follow. On the basis of the discussion presented here, we suggest that Pakistan has evolved these structural conditions without a Structural Adjustment Programme. For this reason, too, it did not need a Structural Adjustment Programme.

While Pakistan's economy needs better management, reform, alignment, etc. the critical question is whether it needs to run to the IMF every three years and accept the consequences of conditionality. Is it possible that the country can deal with its internal problems by itself? And if so, *why* does each government of Pakistan run to the IMF for more stringent conditions, more loans, and much more debt?

17.6.3 Why Does Pakistan Accept IMF Programmes?

There seems to be very little or no debate about why certain policies are being implemented in Pakistan. Why we have to subscribe to an IMF/World Bank-sponsored programme is not discussed, at least not amongst academics, who one would think are equipped to do so. Pakistan is told to follow certain guidelines, policies, and packages, and it complies, trying to show how it is possible to change an indicator here or there. Pakistani academics and economic managers seldom question either the intentions of the programmes or the basic theory and philosophy behind the policies; they simply do what they are asked to. This has been the experience of the IMF programmes in Pakistan. It is difficult to find academic articles that actually *question the need for a programme in the first place*. There is no political debate either. There are, at best, a handful of scholars and journalists who question the repercussions of a Structural Adjustment Programme on the economic and human condition of the populace, and who say that, if we accept the programme, the 'people' will suffer, but they too do not question the reasoning behind or the content of the programmes. One critic writes: 'we argue not against the necessity of structural adjustment, but against the adverse entailments of such adjustment'.[26] The question is: why *not* argue against structural adjustment? Does the author accept the need for such a programme and does he merely want to improve on it? Moreover, even the ultra-conservative *Economist* recognizes that 'many of its [the World Bank's] programmes designed to help the poor—called things like "social dimensions of adjustment"—are safety nets, not ways of lifting people out of poverty'.[27] In countries where there have been protests against IMF-sponsored programmes, academics, NGOs, popular groups, and unions have played critical roles. In Pakistan there seems to be limited opposition to such programmes (see Box 17.8).

Studies are commissioned by the international financial institutions on issues that tend to justify the policies of the World Bank and the IMF. Resource mobilization, trade and tariff reform, agricultural credit, studies on the informal sector, the need for capital markets, etc. are areas that have recently been interesting Washington. Hence a large number of scholars and institutes are mobilized on these studies where the general guidelines have already been put down, and all that the researchers are asked to do is to supplement and justify the general arguments being recommended. Pakistan does not have its own agenda, nor do policymakers or even scholars think for themselves and devise their own arenas of research. Not only that, they fail to question the more general principles behind the research agendas set from afar.[28]

One Pakistani social scientist argues that 'the major reason for [the Pakistani intelligentsia's] failure is that its source of inspiration and point of reference was not the objective study of its own society, with whom it has progressively lost contact to become part of the first world'.[29] Another argues that:

> Post-colonial governments continue with the cultural agenda of colonialism (modernization and development). They also serve as economic agents of their principals. In this role, they ensure, through 'liberal' economic policies, that their charges do not compete with their principals in global markets. They provide familiar and hospitable institutional arrangements to foreign investments. Above all, they ensure that the unsustainably large flows of interest payments on foreign debt are remitted abroad, while managing the levels of local discontent.[30]

While this may be true in the case of some countries, it does not explain how other post-colonial states have managed to avoid problems of this nature. However, Pakistan would fit this general model, since it has always been closely aligned with the West—see Chapter 25. Maybe it is its colonial hangover that has made it dependent on the decree from elsewhere, when political and economic managers only do what is good for the country when they are told. Or it may be due to the fact that military rule has taken away the Pakistani intelligentsia's ability to create new ideas, and hence, Pakistan's academics and professionals are only good at following orders. These are questions that must be addressed.

Although much of the criticism launched by academics against the imposition of structural adjustment policies has been directed against both the IMF and the World Bank, we argue that it is quite unfair to blame the IMF for the ills that plague Pakistan's economy. The IMF is justified in imposing any condition when extending a loan. It must ensure that the money is returned, and for that purpose it must also make sure that the money lent is used for a purpose which, in the Fund's view, will improve the economy so that the country is in a position to return the loan. As such, to castigate the IMF for imposing 'harsh' conditionalities is futile, for the problem lies elsewhere—see Boxes 17.9 and 17.10.

Box 17.8

Pakistani Non-Governmental Organizations (NGOs) Assess Pakistan's Experience with Structural Adjustment Programmes

In March 1995, the World Summit for Social Development was held in Copenhagen, Denmark. The United Nations was the convenor and asked each member country participating to produce its Country Report. A group of NGOs in Pakistan felt that Pakistan's Country Report failed to analyse critically the domestic impact of World Bank/IMF policies and, instead, unquestioningly promoted a market-based economy and growth model. In response to the Country Report, these NGOs prepared 'An alternative NGO statement' which, in particular, criticized the government's adherence to the Structural Adjustment Programme. An excerpt from the alternative statement is presented below:

> Since the onset of the medium term Structural Adjustment Programme (SAP) in 1987–88, the socio-economic conditions of the poor, particularly women, have markedly deteriorated. There appears to be a direct association between the implementation of the SAP under the supervision of the IMF and the World Bank and a deterioration in the standard of living of the lower income classes.
>
> The withdrawal of subsidies has hit the poor through price increases of essential commodities. Prior to the implementation of the SAP package, the bulk of subsidies were on wheat, sugar, and edible oil which are important components of the total consumption of the poor. Not only have total subsidies declined but the share of wheat, sugar and edible oil in these subsidies has also declined sharply. This decline in subsidies was accompanied by an increase in the support price of wheat. In addition, the price of kerosene and petrol rose by about fifty per cent between 1987–88 and 1990–91. Since food constitutes a much larger share of the consumption basket of the poor than the rich, the dramatic increase in food prices has meant that Structural Adjustment has hit the poor much more than the rich. Similarly, the increase in energy prices has placed a disproportionate burden on the poor.
>
> The burden of taxation over the period between 1987–88 and 1990–91 has also been borne largely by the poor. Taxes on the poor increased by 10.3 per cent while those on the richest group declined by 4.3 per cent between 1987–88 and 1990–91.
>
> As a part of Structural Adjustment, trade liberalization and exchange rate flexibility have been followed. The rupee devaluation, recommended by the IMF to promote exports and reduce the trade deficit, has brought no change in the balance of trade. In fact it has resulted in inflation since imports are now more costly.
>
> As part of Structural Adjustment, interest rates are now to be market determined. Despite high interest rates, the saving rate has remained low. Moreover, high rates of interest have had a negative impact on the growth rate. The rich who are able to save are obviously benefited by high interest rates. Moreover high interest rates are likely to result in a ballooning of the fiscal deficit. Interest payments amounted to one-fifth of total federal government expenditure in 1991–92 or about four-fifths of the overall deficit of 78.65 billion in 1991–92.
>
> Accepting SAP means conceding autonomy in economic policy and a failure of leadership. Instead of living within our means, it has extended the begging bowl. Those who have put the poor in this predicament are immune from the negative repercussions of SAP. It is paradoxical that the poor must count on the same leadership for humane social and economic policies.
>
> Responding to calls by the IMF and the World Bank for financial discipline, the government froze wages while jobs in the public sector were restricted as a result of a ban on recruitment and the encouragement of an early retirement via the government's 'golden handshake' scheme. There has been no significant increase in jobs through investment in the private sector. Even the much doubted official unemployment statistics show a marked increase in unemployment between 1987–88 and 1990–91 in various categories of the work force. Amongst the clerical, sales, services, agriculture, production, and related workers categories, unemployment increased dramatically over the period between 1987–88 and 1991. Unemployment has been accompanied by increasing inequality and poverty.
>
> The impact of Structural Adjustment is particularly adverse for women since this economic model relies on the devaluation of labour in the formal and informal sectors so as to lower production costs. Women workers are the most harshly affected by these programmes, as they constitute the majority of home-based workers and are the least protected by statutory wage, security, and safety standards.
>
> Major investment is needed in the productive sectors and infrastructure, with affirmative biases towards those areas which need to be nurtured for achieving equitable development. At the same time there needs to be a reduction in budgetary allocations to the defence establishment and civil administration. Their share of the budget, along with the cost of overall debt servicing, are a huge and unacceptable burden on the nation's resources.

Source: *The Nation*, 7 March 1995.

It is Pakistan's governments, past and present, that are responsible for the state of its economy. It is they who have signed agreements with the IMF, accepting the latter's conditionalities and promising to take measures that are not always beneficial or popular. If a government is forced to go to the IMF, the lender of last resort, it is only because it has not been able or unwilling to take immediate and important steps itself—see Box 17.11.

Take, for instance, two areas of critical concern: low resource mobilization and excessively high expenditure. Clearly, it is not the IMF that is responsible for either of these shortcomings, but rather the inability of various governments to tackle these structural concerns.

Box 17.9

Is the IMF to Blame for Pakistan's Ills?

There is a widespread tendency in Pakistan and in other developing countries to hold the IMF responsible for many problems in the economy. Are these the creation of the IMF? Are they excaerbated by the IMF? Meekal Ahmed, a former IMF employee, looks at Pakistan's economic problems and questions whether the IMF is responsible.

Apportioning all our economic ills to the IMF is the usual IMF-bashing that we enjoy. First, it is claimed that the IMF programme has increased poverty. I would have thought that it was Pakistan's recent nightmarish experience with galloping inflation when the headline rate of inflation peaked at a staggering 25 per cent per annum that pushed millions into poverty. The IMF programme has helped bring inflation down in Pakistan, not push it up, thereby helping people climb back out of poverty as prices stabilize and start to come down.

Secondly, it is argued that high interest rates are hurting industry and employment. High interest rates are a very minor factor when compared to the crippling effects of power outages. It is difficult to separate out the effects of the two, and other factors such as the security situation and the recent global recession, unless we undertake some sort of 'factor analysis'. Nevertheless, having no power to run our factories for up to 18 hours a day must be having serious economic consequences. Furthermore, it is not clear how high interest rates are. If we adjust for present inflation, a 'real' interest rate of around 2 per cent is not high. With inflation on the upside at present and threatening to rise, I see no room to cut interest rates further at this time.

Senior economist Naveed Anwar Khan's complaint is that while the world is applying stimulus measures to help their economies grow, Pakistan is doing the reverse under IMF advice. This is disingenuous. The global economies, with the IMF, the high priests of fiscal rectitude prodding them along, are indeed implementing strong fiscal and monetary policy-easing measures because most of them have the room to do so. India had, and probably still has, a current account deficit of a little over 1 per cent of GDP with ample foreign exchange reserves, including the gold it just purchased from the IMF. Inflation, while rising, is still low at around 4.7 per cent per annum, although the Indian central bank has already signalled a bias towards raising interest rates to keep inflationary pressures at bay.

Pakistan had a fiscal and external current account deficit of 8 per cent of GDP, an inflation rate of 25 per cent per annum, massive capital flight and vanishing foreign-exchange reserves when it turned to the IMF. It is true that the economy has been brought into better balance since then. The external current account deficit has fallen, inflation has come down, there is fresh public and private capital inflow, asset markets have stabilized, and, with surging workers' remittances and IMF financing, our foreign exchange reserves have been built up to more comfortable levels. But the nascent economic recovery we are witnessing is fragile and tentative and subject to downside risks. The last thing Pakistan needs is a 'double-dip' economic downturn because we do something unwise and precipitate on the policy front. Any easing of macroeconomic policy must therefore be done cautiously.

In actual fact, whatever easing in policy that we have seen has made many economists uncomfortable. The IMF has loosened our fiscal deficit target for this year by arguably more than can be judged to be prudent, and probably will do so again next year. While some easing of the fiscal stance is desirable so as to cushion the economy's downturn and impart some demand stimulus, a too rapid easing not only harbours the risk of bringing inflation back with a vengeance just as we seem to have beaten it, but will require interest rates to be pushed back up again to compensate both for the easing on the fiscal side and to keep real interest rates in positive territory to control demand, the ensuing flood of liquidity, and inflation. That would be the worst outcome of all.

There is a sensible and well-meaning suggestion to tie all future releases of IMF money to better governance in the recipient country. It may surprise many to learn that efforts to do so in the past have been vehemently resisted by the developing countries themselves, including Pakistan, in the IMF and World Bank Executive Board where such issues some up for consideration and debate.

Source: Ahmed, Meekal, 'Blaming the IMF', *The News*, Karachi, 20 January 2010.

The taxation structure in Pakistan is wrought with numerous loopholes and exemptions, not to mention rampant corruption, ensuring that a large part of taxable income goes untaxed—see Chapter 10. Various quarters act to preserve their vested interests by demanding and usually acquiring exemptions in taxation. For example, there is as yet no effective agricultural income tax in Pakistan, even though 21 per cent of GDP is contributed by the agricultural sector. Most influential people, agriculturists as well as others, do not pay any tax at all, and only 1.5 million individuals out of a population of 180 million pay income tax. Surely, many more than this 1 per cent of the population earn the minimum taxable 42,000 rupees per month. The inability or unwillingness of the government to ensure an equitable, just, and extensive taxation structure ensures low resource mobilization. This in turn results in a high fiscal deficit, with its numerous repercussions. Another area where successive governments have chosen not to express concern is defence expenditure. With close to 3 per cent of GDP being spent on defence, little remains for development. In fact, Pakistan must be one of the very few countries in the world where annual defence spending has exceeded development expenditure. Although the political economy of the state does not permit the government to tackle the issue of military spending, it is certainly time to do so.

Box 17.10

IMF Credit, Macroeconomic Stability, and Growth Sustainability

M. S. Qazi examines the broad features of the 2008/9 IMF SBA and shows what it was expected to achive. Noticeable is that the loan was meant to have specific interventions as has been shown in Appendix 17.1, but as well as to, 'is to restore the confidence of domestic and foreign investors which will help to improve the macroeconomic imbalances'. He also makes the claim that the PPP government had to go to the IMF because of the poor policies adopted by the Musharraf–Shaukat Aziz government of 2002–07.

Pakistan is to get a $7.6 billion IMF credit facility under a 23-month Stand-by-Arrangement (SBA). An amount of $4.0 billion in credit is due during the current fiscal year to meet sovereign commitments and the remaining amount will be disbursed during the next fiscal year. According to the IMF, the credit is to restore the confidence of domestic and foreign investors which will help to improve the macroeconomic imbalances by tightening the monetary and fiscal policies. It is also to protect and preserve social stability through a well targeted and adequately funded social safety net.

On the sidelines it can also convince the Friends of Pakistan Forum to work with Pakistan. The Forum, during its meeting held on the 16 November this year, laid down a framework to extend support for economic development, security, financial stability, institution building, and energy sector development. It will take its own time and modality to render effective assistance which is needed immediately. This time the government and stakeholders need to resolve that the credit is meant for achieving a long-term objective of high and sustainable economic growth unlike past experiences which only considered short-term objectives.

Some of the opinion makers in the country such as the financial analysts, economists, and stakeholders are critical of the government's decision to opt for the IMF credit as it might scuttle growth and create more difficulties than resolving them, primarily because of tough monetary and fiscal policies. The government will be under obligation to reduce PSDP and impose new taxes to generate at least Rs. 70 billion during the current fiscal year. The financial adviser to the PM is emphatic that credit facilities are being availed more because of home grown measures and less because of IMF conditionalities. He might be down playing IMF conditionalities but the fact remains that the State Bank of Pakistan (SBP), had to hike the discount rate by 2.0 per cent prior to the IMF agreeing to lend the credit.

The government will have to execute comprehensive short, mid and long-term strategies of economic growth and development where all stakeholders should be taken aboard. Is the government preparing for such an eventuality?

The current economic crisis is the result of a misplaced economic growth and development strategy pursued from 2003. Its pivotal points were to encourage public consumption, boost growth, allow indiscrete import of food and consumable items to meet increase in aggregate demand and enabling the banking sector to make best use of excess liquidity by facilitating consumer financing on a western consumption model. It depended on proceeds of privatization, remittances, financial assistance from the US in return of logistics that the government provided as a frontline state in US-led war on terrorism and credit inflows from multilateral organizations to strengthen external financial sector. Such a strategy created illusive macroeconomic stability and high economic growth of around 7.0 per cent during FY-2004–07. The agriculture and industrial sectors did not get the attention and investment they deserved. The strategy worked for sometime but hazards inherent in it started showing earlier than expected.

There were three very conspicuous consequences that led the economy to the existing state of affairs. First, inflation started raising its head soon after stabilization and increase in economic growth. It had a steep increase to 8.0 per cent in 2005 from an average rate of increase of around 4.0 per cent during previous three years when the government was busy implementing IMF recipe under PRGF, till end December 2004 and growth rate was low, around 3.5 per cent. Two, supply side of economy could not keep pace with demand and pressure on imports of finished goods and food products increased. It started aggravating trade deficit and balance of payment situation with the result, the latter that was surplus in 2004 started turning into deficit creating a very unpleasant situation by the end of the last fiscal year. It reached $14.0 billion, 8.0 per cent of GDP. The added factor in such a huge current deficit was an increase in the prices of oil and food items in the international market. Three, the monetary policy pursued by SBP did not yield the desired result of containing inflation because there was hardly any harmony between fiscal and monetary policies.

The most deplorable aspect of the growth and development strategy followed during FY-2000–07 was that it did not take measures to increase employment, ensure increase in production in industrial and agriculture sectors, production and supply of electricity to consumers at competitive price, boost exports, and develop infrastructure required for a sustainable high economic growth. It also did not create efficient social security networks to ensure financial support for the most vulnerable segments of society from internal and external shocks to the economy.

In the meantime the adviser to the PM outlined a comprehensive and integrated strategy for economic growth and development based on, (a) reducing non-development expenditure and PSDP, in order to reduce fiscal deficit to 4.7 per cent during current fiscal year, (b) creating harmony between monetary and fiscal policies, (c) increasing productivity of industrial and agriculture sector on priority basis, (d) reducing trade deficit, current account deficit and (e) taxing the agriculture sector, real estate and stocks (f) increasing the tax-to-GDP ratio from around 10.0 per cent to around 15.0 per cent during next five years for achieving macro-economic stability and sustainable high economic growth.

The strategy suggested by adviser to the PM is a clear break from policies of the past seven years. Their implementation would need strong political will and acumen in governance and managing economy.

Qazi, M. S., 'IMF Credit, Macroeconomic Stability and Growth Sustainability', *The Investor*, *The News*, Karachi, December 2008

Box 17.11

Pakistan and the IMF: Why Does the Relationship Endure?

Muhammad Yaqub, a former Governor of the State Bank of Pakistan, examines the long-term, and long-lasting relationship between Pakistan and the IMF, and examines the reasons why both the IMF and Pakistan, despite so many failed programmes, continue to engage with each other. He argues that despite more than a dozen programmes, all but one of which have been abandoned, the IMF programmes are primarily 'helpful once again in saving a government, but not in improving the fundamentals of the economy'.

The IMF has been off-and-on involved with Pakistan for more than thirty years. At present, Pakistan has no operational arrangement with the IMF. However, it owes the IMF about $8 billion: $1.8 billion is due to be paid to the IMF in 2012, $3.9 billion in 2013 and $2.1 billion in 2014. Thus, in the absence of a new arrangement, Pakistan will have to repay a total net amount of $7.8 billion to the IMF in a period of less than three years. The foreign exchange reserves of the State Bank of Pakistan (SBP) at present amount to $11.8 billion. The country is running an annual current-account deficit of around $5 billion, to be financed largely by drawdown of reserves.

It is obvious that any time in the next two-three years the country will default in its payments to the IMF and/or other creditors, in the absence of another borrowing arrangement with the IMF or substantial net lending by other foreign sources. If there is a run on reserves in anticipation of external debt default or to meet future import requirements, the SBP will exhaust its reserves earlier than indicated above. No wonder that there is again a talk in official circles of going back to the IMF for another borrowing arrangement in the foreseeable future.

The past borrowing arrangements made by various governments with the IMF were based on a commitment by the governments to adopt certain economic policies to achieve balance of payments viability. Those policies were made by the IMF a part of its conditionality for disbursement of its loan, but those were the policies willingly accepted for implementation by successive governments. The IMF staff presented those policy programmes to its board, assuring it that those policies will indeed work to improve the balance of payments during the programme period so that the country will be able to pay back the loan to the IMF on due dates, and, after a stabilization of the economy, will attain a higher rate of growth with relative price stability and balance-of-payments viability.

The ground reality is that the IMF programmes only bailed out particular governments in periods of crisis, and avoided international financial turmoil emanating from potential defaults, but the underlying state of the economy has gradually gone from bad to worse in all that period. The fundamental question is as to why the economic policy programmes worked out with the IMF have not led to an improvement in the economy and strengthening of the balance of payments, and why is it that the IMF and Pakistan have remained engaged with each other in spite of the fact that their long association and successive policy programmes have failed to produce any positive returns for the country? The answer lies not in deficiency in policy prescriptions but in motivating factors on both sides behind these programms.

The governments knocked at the doors of the IMF in critical times not to reform the economy but to borrow from the IMF, supplemented by additional lending/debt relief by other international financial institutions and bilateral sources, to meet their immediate foreign exchange requirements. There was a lack of genuine commitment by successive governments to carry out the necessary policy reforms.

The real purpose, indeed, was to dodge the bullet and mark time by relying on borrowing from the IMF. In implementing the policy package, the easier policy actions were taken on time, some of the targets and ceilings were met on paper only through statistical manipulations engineered by bureaucrats, and when it came to hard policy choices either waivers were requested or programmes abandoned. Successive political leaders were thus able to save and sustain their governments by borrowing from abroad without any genuine effort to undertake the needed difficult reforms.

The role and behaviour of the IMF was less clear and more intriguing. It appears that the IMF adopted its accommodative approach of granting waivers and agreeing on repetitive arrangements in spite of the poor track record of implementation of policies for any or all of the following reasons:

First, the IMF played in the hands of its major shareholders who used it to help sitting governments at critical times to keep them floating by using its clout in the IMF and thereby to promote their own security and other national objectives. Unlike the UN General Assembly, the IMF has a weighted voting system in which the US and its European allies have voting majority.

Second, the IMF wanted to remain engaged with the country to avoid the consequences for the international financial organizations and for world financial markets of a debt default by a major debtor country of Asia. It may be recalled that major debt of Pakistan is owned to the IMF, the World Bank group and the Asian Development Bank.

Third, the IMF staff did not do its job properly and misled its board in presenting the economic programme that met the board requirements but was based by the staff on unrealistic estimates relating to the budget, the balance of payments outlook and some other aspects of the economy.

Viewing the IMF-Pakistan relations in the historical perspective of more than thirty years, the most important conclusion that emerges is that every government approached the IMF for financial help, after the economy has been mismanaged for some time, only to avoid foreign exchange shortage, external debt default and an economic crisis. They succeeded in getting external financial assistance and avoiding a crisis, but failed to undertake important economic reforms.

Given the past record of broken promises and abandoned programmes both the government and the IMF should seriously review their track record for a more meaningful future arrangement that helps the country out of its deep-rooted problems, rather than bailing out a sitting government or avoiding turmoil in the international financial system. For the sake of Pakistan, both should change their approach.

The government does not need the IMF to diagnose Pakistan's problems and find the solutions. Any economist of standing can formulate a correct policy package: control government expenditure, raise the tax/GDP ratio, reduce the budget deficit, dismantle the underground economy, eradicate corruption, privatize or restructure public-sector corporations, free the SBP to conduct a prudent monetary policy to encourage private sector activities and control inflation, have an export-led growth strategy financed by mobilization of domestic savings, build strong economic institutions and ensure good governance. The SBP should be able to help the government to cast its own home-grown program in the IMF mould, ensuring consistency, viability and balance-of-payment sustainability, by using its macroeconomic framework that is very similar to that of the IMF.

A home-grown programme so developed to tackle the country's structural problems, keeping in view the financial programming framework of the IMF, can be 'sold' to the IMF to galvanise the necessary external financial assistance by a technically competent economic team. But statistical trickery and false promises should be replaced by a genuine effort to address the deep-rooted economic problems of the country.

The IMF should accept for financial assistance a genuine programme developed and owned by the government to stabilize the economy and promote a higher rate of growth with relative price stability and balance-of-payment viability, even if it is modest in its contents. It is better to support a programme that is owned by the country and implemented seriously than to impose an ambitious programme on paper that is likely to fall apart at the implementation stage.

If a government is not committed to implementing its home-grown programme with full ownership of policies, visits to the IMF headquarters and agreement on a programme paper with the IMF may be helpful once again in saving a government, but not in improving the fundamentals of the economy.

Source: Yaqub, Muhammad, 'Pakistan and the IMF', *The News*, Karachi, 22 May 2012.

Just these two examples highlight the fact that whatever mess Pakistan's economy finds itself in is due not to the meddling and interference of the IMF (although that does exacerbate the problem), but is largely of our own creation. In order to ensure their extended survival, governments do not touch controversial issues such as agricultural income tax and military spending. Instead, they rush to the IMF for financial assistance, continuing to delay the day of reckoning. They acquire loans to meet their revenue gap, so that unpleasant measures can be avoided. In all this, if the people of Pakistan have a voice, it must be directed at criticizing the wrongdoings of their elected and unelected officials, not the representatives of an international bureaucracy. By blaming the IMF, one is simply letting the government off the hook.

It is the government—the numerous that the country has had—that is responsible for the state of Pakistan's economy and it should be accountable to its people. Popular pressure should be directed towards demanding reforms that will improve the structure of the economy so that there is no need to borrow under harsh conditionalities. Whether it be agricultural income tax or land reforms, military spending or development expenditure, the government should be forced by public opinion and public pressure to undertake the extensive reforms that are long overdue. Instead of blaming the IMF, there is need to examine the role of academics, the intelligentsia, and government (see Appendix 17.2 for different ways of looking at the problems in the economy and for alternative solutions).

17.7 Summary and Further Reading

17.7.1 Summary

Having presented in Chapter 16 a general overview of the Structural Adjustment Programme and its impact on and consequences for those countries that have adhered to it, this chapter has examined the specific case of Pakistan and its experience. We started with an extensive and detailed overview of what the programme involves in the case of Pakistan and with a history of the IMF's involvement. It seems that Pakistan has been rather eager to seek IMF assistance in recent years, and some writers have argued that the way these loans have been agreed to gives rise to speculation that some non-economic factors may also have been involved.

We examined the analysis made of the Structural Adjustment Programmes by the World Bank and the IMF themselves, and found that these two organizations were not totally satisfied with the outcomes, as many targets were missed. More importantly, independent research that has been done on the impact of the programme shows, very clearly, that the repercussions have been severe for poverty, employment, wages, and inequality. Moreover, some of the outcomes of a Structural Adjustment Programme, like higher growth and lower inflation, have not manifested themselves in Pakistan, with growth being considerably lower and inflation higher than trend levels. In Chapter 22, we argue that one of the main reasons why there has been such a noticeable rise in poverty in Pakistan, has been due to the adherence of such Structural Adjustment Programmes.

We also analysed the political economy of the Structural Adjustment Programme and tried to examine why, if the repercussions of the programmes are so negative, the government of Pakistan runs to the IMF on the smallest pretext. The answer, we suggest, lies in the way Pakistan's élites and its political settlement works. Pakistan has not even needed a Structural Adjustment Programme sponsored by the IMF and the World Bank, yet finds recourse to their assistance. Because it is easier to acquire loans from such organizations than to implement far-reaching changes in

the economy, such as an agricultural income tax, a cut in defence expenditure, and the elimination of conspicuous consumption, the rulers in Pakistan make use of so called 'aid and assistance', having very serious repercussions for the economy overall—also see Chapters 18, 22 and 25.

17.7.2 Further Reading

The reading list provided in the previous chapter should be consulted, since it contains a good general overview of the Structural Adjustment Programmes. For Pakistan, the four World Bank reports are essential.: *Pakistan: Growth Through Adjustment*, Report No. 7118-Pak (Washington DC: World Bank, 1988); *Pakistan: Medium-term Economic Policy Adjustments*, Report No. 7591-Pak (Washington DC: World Bank, 1989); *Changes in Trade and Domestic Taxation for Reform of the Incentive and Fiscal Adjustment*, Report No. 9828-Pak (Washington DC: World Bank, 1992) and *Pakistan: Country Economic Memorandum FY93*, Report No. 11590-Pak (Washington DC: World Bank, 1993). The IMF and World Bank web pages now contain a huge amount of material which is updated regularly and essential reading for anyone interested in these issues.

In addition, the special issues of the *Pakistan Journal of Applied Economics*, vols. 10 and 11, 1994, 1995, contain some very useful articles In particular, see: Zaman, Arshad, 'The Government's Present Agreement with the IMF: Misgovernment or Folly?', *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995; *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995. Shahrukh Rafi Khan's *Do IMF and World Bank Policies Work?* (London: Macmillan, 1999) is an excellent extensive evaluation of IMF and World Bank policies in Pakistan, and for more recent analysis, see his 'Structural Adjustment and its Impact', in Zaidi, S. Akbar (ed.) *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003). Also see the articles in Shahrukh Rafi Khan's edited *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999). Numerous articles published in the *Pakistan Development Review* also present detailed evaluations and critiques of the impact of structural adjustment in Pakistan and are recommended as they are an excellent source for material. A monograph written by Imran Khalid-Khan for the Bank Information Center in Washington DC, is highly recommended: see, 'Strategic Lending on the Frontlines: The Case of Pakistan', mimeo, (Washington DC: Bank Information Center, 2004). The readings in Chapters 18 and 22 would also be very useful for anyone interested in issues raised in this chapter.

Appendix 17.1

Pakistan's Stand-By Agreement with the IMF to Access $7.6 Billion November 2008 (subsequently increased to $11.3 billion)

A. Macroeconomic outlook and policies

The government's financial policies for the remainder of 2008/09 and for 2009/10 are aimed at stabilizing the macroeconomic situation and restoring investor confidence. The government's program envisages a significant fiscal consolidation, and the SBP will tighten monetary policy to lower inflation and strengthen the international reserves position. As a result of these policies, the 12-month inflation rate is projected to decline to 20 per cent at end June 2009, even after taking into account the impact of significant increases in administered energy prices. Real GDP growth would slow further to 3–3½ per cent in 2008/09 in response to the tightening of macroeconomic policies and a deceleration of growth in Pakistan's trading partners.

The tighter financial policies, higher disbursements from IFIs, lower commodity prices, and restored confidence are expected to contribute to a significant strengthening of the external position in 2008/09. Specifically, the external current account deficit is projected to narrow to $10.6 billion (6.5 per cent of GDP) owing mainly to slower aggregate demand growth and lower oil import prices. At the same time, the surplus in the financial account would decline to $6.2 billion, as an increase in disbursements from IFIs (to about $4 billion) would be more than offset by weaker FDI and portfolio flows relative to 2007/08, reflecting in part the impact of the global financial turmoil. Given the target to increase gross official reserves to $8.6 billion by end June 2009 (the level prevailing at end June 2008), the residual financing gap of $4.7 billion will be covered by drawing on IMF resources. To further bolster confidence, the government is seeking additional financial support from donors.

The government's medium-term strategy seeks to achieve high sustained growth and significantly reduce poverty, while ensuring external and fiscal sustainability. Following the initial stabilization effort in 2008/09, real GDP growth would increase to 5 per cent in 2009/10, and is projected to rise gradually to 6½–7 per cent a year by 2012/13, based on a significant increase in investment and further progress in structural reforms. Average inflation is targeted to decline to 13 per cent in 2009/10, and to 5 per cent by 2012/13. Prudent demand management policies would contribute to a gradual decline in the external current account deficit to 5.7 per cent of GDP in 2009/10, and further to 3.6 per cent of GDP by 2012/13. This, along with the expected pickup in capital inflows, would help increase gross international reserves to $14.5 billion (2.6 months of projected imports) by 2012/13, while reducing the external debt to 29 per cent of GDP. The external financing gap for 2009/10, which is projected at $3.6 billion, will be covered by disbursements from the IMF and GDR proceeds. External financing gaps will be fully eliminated by the end of the SBA.

B. Fiscal policy

The fiscal deficit (excluding grants) is targeted to decline to 4.2 per cent of GDP (Rs. 562 billion) in 2008/09, from 7.4 per cent in 2007/08. This fiscal effort is necessary to

help reduce the external current account deficit, move toward a sustainable fiscal position, and eliminate SBP financing of the government. To achieve the 2008/09 deficit target, the government will increase tax revenue by 0.6 percentage points of GDP and reduce non-interest current expenditure by about 1½ percentage points of GDP, mainly through the elimination of oil subsidies by December 2008 and electricity subsidies by June 2009. At the same time, domestically-financed development spending will be reduced by about 1 percentage point of GDP through better project prioritization.

The government has already implemented a number of measures consistent with the envisaged fiscal adjustment in 2008/09. Specifically, petroleum prices have been adjusted three times since June 2008, which has led to the complete elimination of petroleum subsidies. At the same time, electricity tariffs were adjusted by an average of 18 per cent effective 5 September 2008. In addition, steps have been taken to slow the pace of development spending, the research and development subsidy for the textile industry has been fully eliminated, wheat procurement prices have been raised to international levels, and the general sales tax (GST) rate has been raised by one percentage point to 16 per cent.

The government plans to take additional fiscal measures in 2008/09. As noted above, electricity tariff differential subsidies will be fully eliminated by end June 2009. To achieve this objective, the average base tariff will be further increased during 2008/09 according to a schedule to be agreed with the World Bank by end December 2008 (structural benchmark), and the government will use fuel and other surcharges, as necessary. The implementation of the electricity tariff increases will be followed up in the context of the program reviews. On the revenue side, further steps will be taken during the remainder of the fiscal year to strengthen tax enforcement. Moreover, fuel prices will continue to be adjusted to pass through changes in international prices.

An expanded and effective social safety net constitutes an integral part of the authorities' program. In this regard, several measures are envisaged to protect vulnerable groups that might be adversely affected by inflation and the economic slowdown. The fiscal program for 2008/09 envisages an increase in social safety net spending of 0.6 percentage points of GDP, to 0.9 per cent of GDP. To this end, the government has launched the Benazir Income Support Program (BISP), for which the budget already allocated Rs. 34 billion (0.3 per cent of GDP). The design of the BISP, in particular the targeting of transfers and the delivery mechanism, will be reviewed in the first half of 2009, in consultation with the World Bank. The government also plans to expand social safety net spending by an additional 0.3 per cent of GDP, for which further external assistance (mainly in the form of grants) is being sought from donors. While a more comprehensive and better-targeted social safety net is being designed, these additional funds will be allocated to scale up other existing programs, in particular cash transfers under the Bait-ul-Mal program. Also, part of the additional resources could be used to cover larger than envisaged electricity subsidies for poor households.

Putting in place a more comprehensive and well-targeted social safety net is a key priority under the program. To that end, in close cooperation with the World Bank, the government will prepare, by end March 2009, a strategy and a time-bound action plan for the adoption of specific measures. The first program review will assess progress in this area. The resources allocated to the short-term protection measures described above will be used for funding the newly designed social safety net in 2009/10.

The government will prepare, by end March 2009, a plan for eliminating the inter-corporate circular debt within the fiscal deficit target. The plan will clearly identify all elements of circular debt, including (i) the identification of all debts owed and due among the corporations, duly reconciled; (ii) the determination of the validity of the claims; (iii) a schedule by which respective entities will discharge their liabilities to each other; and (iv) a time frame during which the Federal Adjuster will use his powers to make adjustments, in case of failure, to adhere to the approved schedule.

The targeted reduction in the fiscal deficit in 2008/09 will help eliminate SBP financing of the budget. The government is committed to limiting SBP financing of the budget to zero on a cumulative basis during 1 October 2008–30 June 2009. During this period, the fiscal deficit will be fully financed by available external disbursements (which have already been committed), the acceleration of the privatization process, the issuance of treasury bills, and other domestic financing instruments, including Pakistan Investment Bonds, Ijara Sukuk, and National Savings Scheme (NSS) instruments.

A further reduction in the fiscal deficit to 3.3 per cent of GDP is envisaged for 2009/10. The fiscal effort will be facilitated by the full-year effect of the elimination of energy subsidies by end-2008/09 and declining interest payments, following large bullet payments in the three-year period ending in 2009/10.

Consistent with the government's objective of substantially increasing tax revenue, a number of tax policy and administration measures are envisaged during the program period. Specifically, an integrated tax administration organization on a functional basis will be established at the Federal Board of Revenue (FBR) (integrating both the income tax and sales tax administration). In addition, audits will be reintroduced as part of a risk-based audit strategy that will be implemented by end December 2008. A full description of the required reforms, together with an action plan will be provided to the IMF by end December 2008, following a planned seminar to review tax policy and administration. As part of this process, the government plans to harmonize the income tax and GST laws, including for tax administration purposes, and reduce exemptions for both taxes. To that end, it will submit legislative amendments to parliament by end June 2009. In addition, the excises on tobacco will be increased in the context of the 2009/10 budget. Following the seminar in December 2008, the government will initiate a process to implement a full VAT with minimal exemptions, to be administered by the FBR. Draft legislation for the VAT is expected to be ready for public debate by end-2009. The first program review will focus on the progress in developing the government's tax reform agenda.

The government's fiscal consolidation efforts will continue over the medium term. The government's fiscal framework assumes a further reduction in the fiscal deficit to 2–2½ per cent of GDP by 2012/13. Fiscal consolidation will be

supported by a strong tax effort, which will allow for higher spending in infrastructure and the social sectors. Specifically, the government is committed to increasing tax revenue by at least 3½ percentage points of GDP over the medium term as a result of measures to broaden the GST base, significantly reduce income tax exemptions, and further improve tax enforcement.

The government will continue to press ahead with public financial management reforms, in line with fiscal ROSC recommendations. Immediate priority will be given to completing the on-going gradual implementation of a single treasury account. This will involve the consolidation of government funds in its account with the SBP, from which withdrawals will be made only when actual payments are due. Existing funds held outside the SBP account will be transferred by end June 2009. Furthermore, the coordination between the Planning Commission, which manages the developmental budget, and the Ministry of Finance will be strengthened in the context of the implementation of the medium-term budget framework.

C. Monetary policy, exchange rate policy, and financial sector issues

The program envisages a significant tightening of monetary policy. To that end, the SBP recently increased its discount rate by 200 basis points, to 15 per cent. Following this first step, interest rate policy will be sufficiently flexible to protect the reserves position, bring down inflation, and allow the government to place T-bills and other securities with commercial banks and non-banks in order to avoid further central bank financing of the budget. A further increase in the discount rate will be considered at the time of the monetary policy statement scheduled for end January 2009. However, the discount rate will be raised earlier if the actual reserves for end November and end December 2008 fall short of the program monthly floors on the SBP's net foreign assets. In addition, if the volume of T-bills placed in the auction scheduled for 19 November falls short of the announced target, understandings will be reached with Fund staff on corrective measures in order to meet the program targets.

The conduct of monetary policy will be facilitated by significant improvements in liquidity management, including by improving the forecasting of the government's cash flow position. As part of these efforts, the SBP and the Ministry of Finance have agreed on quarterly volumes of treasury bill placements consistent with zero SBP financing of the budget during 1 October 2008-30 June 2009. The SBP has issued an auction calendar for November-December 2008 on 1 November 2008, and in the future will issue a calendar every quarter one month in advance. In addition, the SBP will review the current procedures for liquidity management, and will adopt and publicize a transparent liquidity management framework by end July 2009 as part of its Monetary Policy Statement. This framework will contain the following key elements:

- The announcement of an explicit corridor for money market interest rates: the SBP's reverse repo rate will be the ceiling, and a standing repo facility to absorb excess liquidity from commercial banks will serve as the floor of the proposed explicit corridor;
- The treasury will provide the SBP with T-bills, as needed, to conduct its open market operations.

The SBP is committed to pursuing a flexible exchange rate policy. To that end, intervention in the foreign exchange market (including the provision of foreign exchange for oil imports) will be aimed at meeting the program's reserve targets. This primary objective will be facilitated by phasing out the SBP's provision of foreign exchange for oil imports according to the following schedule:

- Furnace oil—by 1 February 2009.
- Diesel and other refined products—by 1 August 2009.
- Crude oil—by 1 February 2010.

During the program period, the SBP intends to eliminate any exchange restriction subject to approval under Article VIII of the IMF's Articles of Agreement. Specifically, the exchange restriction on advance import payments against letters of credit will be eliminated by end January 2010, subject to a marked improvement in the balance of payments position. No intensification of existing restrictions and no new exchange restrictions or multiple currency practices will be introduced during the program period.

The SBP will prepare a contingency plan to deal with problem private banks by end December 2008. The plan will contain criteria for SBP liquidity support, assessment of bank problems, and intervention procedures. The SBP has already dealt with problem banks through mergers. Looking ahead, if there are severe strains in the interbank market and interbank lending guarantees appear necessary, these guarantees will be provided in limited amounts only to solvent banks.

To enhance the effectiveness of SBP enforcement powers, necessary amendments to the Banking Companies Ordinance will be submitted to Parliament by end June 2009. These amendments will strengthen the SBP's ability to (i) change management in banks; (ii) impose losses on shareholders by writing down their capital; (iii) intervene and take ownership of banks; (iv) appoint administrators to operate banks; and (v) restructure banks.

The legal provisions relating to the operational independence of the SBP will be reviewed. These provisions will be strengthened based on the recommendations of an interagency committee that will be established by mid-November 2008, and taking into account technical recommendations from the IMF. The second program review will focus on specific details regarding required legislative changes in this area.

The government believes that market confidence will improve significantly once the Fund-supported program is approved and the international reserves position is strengthened. Therefore, it does not intend to remove the current floor on stock prices until after the program is in place. In any event, the timing and terms under which the floor on stock prices will be removed, including any use of public funds to support the stock market, will be decided after reaching understandings with Fund staff.

Table 1. Pakistan: Quantitative Targets, December 2008–June 2010

	Outst. Stock end Sept. 2008	Prog. end Dec. 2008	Prog. end Mar. 2009	Prog. end June 2009
Floor on net foreign assets of the SBP* (stock, in millions of U.S. dollars)	3,953	1,165	671	2,782
Ceiling on net domestic assets of the SBP* (stock, in billions of Pakistani rupees)	1,250	1,346	1,412	1,314
Ceiling on net government borrowing from SBP* (stock, in billions of Pakistani rupees)	1,227	1,274	1,274	1,181
Ceiling on overall budget deficit* (cumulative flow, in billions of Pakistani rupees)	142	261	405	562
Ceiling on outstanding stock of short-term public and publicly guaranteed external debt* (in millions of U.S. dollars)	515	1,500	1,500	1,500
Cumulative ceiling on contracting of nonconcessional medium- and long-term public and publicly guaranteed external debt* (in millions of U.S. dollars) 1/	9,500	9,500	9,500	9,500
Accumulation of external payments arrears (continuous performance criterion during the program period)* (in millions of U.S. dollars)	0	0	0	0
Continuous ceiling on SBP's foreign currency swaps and forward sales* (in millions of U.S. dollars)	1,900	2,750	2,750	2,750
Memorandum items:				
Net external program financing (in millions of U.S. dollars)	–53	137	918	2,503
External project grants (in millions of U.S. dollars)	1	39	95	180
Foreign Exchange cash reserve requirement (CRR, incl. special CRR) deposits in SBP (in millions of U.S. dollars)	832	832	832	832
Weekly cash reserve requirement ratios (in percentage points) Rupee deposits (less than one year maturity)	9	5	5	5
Rupee deposits (more than one year maturity)	0	0	0	0
Foreign currency deposits CRR	5	5	5	5
Foreign currency deposits special CRR	15	15	15	15

Notes:
* denotes performance citeria.
1/ Excludes IMF.

Prior actions (implemented before Board consideration of the program)

The SBP's discount rate was increased by 200 basis points.

Electricity tariffs were increased by an average 18 per cent effective 5 September 2008.

The SBP and the government agreed on quarterly volumes of treasury bills to be issued, and published the expected volume for the remainder of the second quarter of 2008/09.

Performance criteria

Amendments to the banking legislation will be submitted to Parliament by end June 2009 to enhance the effectiveness of SBP enforcement powers in the area of banking supervision.

The government will submit, by end June 2009, draft legislative amendments to parliament to harmonize the income tax and GST laws, including for tax administration purposes, and to reduce exemptions for both taxes.

Benchmarks

A contingency plan for handling problem private banks will be finalized by end December 2008.

A full description of required reforms in the area of tax administration, including an action plan for harmonizing the GST and income tax administration will be finalized by end December 2008.

In close collaboration with the World Bank, the government will finalize the schedule for further electricity tariff adjustments during 2008/09, by end December 2008, with a view to eliminating tariff differential subsidies by end June 2009.

The SBP's provision of foreign exchange for furnace oil will be eliminated by 1 February 2009.

In close collaboration with the World Bank, the government will develop a strategy and a time-bound action plan, by end March 2009, for the adoption of specific measures to strengthen the social safety net and improve targeting to the poor.

The government will prepare a plan for eliminating the inter-corporate circular debt by end March 2009.

The transition to a single treasury account will be completed by end June 2009.

PROGRAM REPORTING REQUIREMENTS

The following information, including any revisions to historical data, will be provided to the Middle East and Central Asia Department of the IMF through the office of the Resident Representative of the IMF in Pakistan, within the time frame indicated:

- Monthly provisional statements on federal tax and non-tax revenue, within one month.
- Deposits into and withdrawals from the privatization accounts for each quarter, within one month. Withdrawals will be reported with the following breakdown (a) those which constitute budgetary use of privatization proceeds; (b) those which constitute costs of privatization; and (c) other (with explanation of the purpose of other withdrawals), as well as with the breakdown between domestic and external privatization receipts.
- Quarterly statements on budgetary capital receipts and disbursements, including repayments of bonds, recovery of loans from provinces and 'others', within two months.
- Monthly (unreconciled) provisional data on federal expenditure and net lending (with separate data on disbursements and repayments), within one month.
- Quarterly statement on consolidated budgetary expenditure, with federal data approved by the Accountant General Pakistan Revenue (AGPR), within two months.
- Quarterly numbers on expenditure on social programs.
- Quarterly data on the stock of domestic government debt, broken down by instrument, within one month (Table 3).
- Quarterly data on WAPDA receivables within one month.
- Monthly data on Outstanding Audited Price Differential Claims.
- Monthly data on external budget financing, including (i) loan-by-loan program disbursements in U.S. dollar terms and rupee terms converted at exchange rates prevailing at the time of each transaction; (ii) cumulative amortization in U.S. dollar terms and rupee terms converted at exchange rates prevailing at the time of each transaction; and (iii) cumulative project loan disbursements in U.S. dollar terms and in rupees converted at exchange rates prevailing at the time of each transaction.
- Monthly data on Banks' Budgetary Support (Table 1) within one month.
- The following monthly monetary data on a last-Saturday basis within two weeks:
  - (i) monetary survey;
  - (ii) accounts of the SBP;
  - (iii) consolidated accounts of the scheduled banks;
  - (iv) banks' lending to the government;
  - (v) detailed table on net foreign assets (both for the SBP and scheduled banks);
  - (vi) detailed table of scheduled banks' reserves with the SBP.
- The same tables as in the preceding item, but on an end-month and end-quarter basis (last business day), both at current and program exchange rates, within one month.
- The SBP Table on outstanding stock of foreign currency deposits, amended to include the classification of new FCA according to the residency of the holder.
- Daily data on exchange rates (interbank, retail market, and Telegraphic Transfers for SBP purchases in the retail market), SBP's sales and purchases in the foreign exchange markets, swaps and forward outright sales, within two business days.
- Monthly data on the outstanding stock of the SBP's forward foreign currency operations, including swaps and outright forward sales and purchases, within two weeks. The terms of any new transactions (including rollover/renewal of existing ones) will also be provided.
- Monthly data on the SBP's foreign exchange reserves, with details on the currencies, instruments, and institutions in which the reserves are held, within one month.
- Monthly data on SBP direct or bridge loans to nationalized banks in the context of the restructuring and privatization operation, within four weeks.
- Monthly data on any other quasi-fiscal operations undertaken by the SBP, on behalf of the government.
- Monthly data on SBP holding of discounted export finance credit under the export finance scheme, within one month.
- Monthly data on outstanding credit to agriculture under the Agriculture Mandatory Credit Targets, within one month.
- The following data on external debt, within one month:
  - (i) Quarterly stock of public- and publicly-guaranteed external debt (including deferred payments arrangements), by maturity (initial maturities of up to and including one year, and over one year), by creditor and by debtor (central government and publicly guaranteed);
  - (ii) Quarterly contracting or guaranteeing of non-concessional medium- and long-term government debt; and
  - (iii) Information on any rescheduling on public- and publicly-guaranteed debt reached with creditors.
- Quarterly data on external payments arrears on public and publicly guaranteed debt with details as in (i) of the preceding item within one month.
- Copies of new or revised ordinances/circulars regarding changes in: tax policy, tax administration, foreign exchange market regulations, and banking regulations no later than three days after official issuance, or notification that ordinances have been posted on the Federal Board or Revenue (FBR) and SBP websites.
- Copies of official notification of changes in gas and electricity tariffs and any surcharges (automatic or structural) and in ex-refinery petroleum product prices as well as of gas and petroleum surcharges/levies.
- Monthly data on the import parity prices as well as central depot prices of the six major oil products, within one month.
- Quarterly data on KESC and WAPDA loans and debt outstanding, within one month.
- Upon the adoption of the plan for the elimination of inter-corporate circular debt, monthly reports on inter-corporate circular debt will be reported within 1 month.

Source: Adapted from: *Pakistan: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding*, IMF, 20 November 2008

Appendix 17.2

The Alternative to the IMF/World Bank Policies

Do underdeveloped countries like Pakistan and India have any alternative to IMF/World Bank dependence? Professor Prabhat Patnaik and C. P. Chandrasekhar examine the possibilities:

> What comes through clearly from the Indian experience with structural adjustment is the dominant role of the process of globalization of finance. We have suggested earlier that indeed the very design of the current package of structural adjustment bears the imprint of this process; and the sequel to the introduction of this package shows that the real mobility witnessed is that of finance rather than that of capital-in-production. But then if globalization of finance restricts the possibility of intervention within a 'national' (or for that matter any supranational but restricted) space by undermining the concept of a 'control area', the question naturally arises: can there be any sort of an alternative to the current set of policies? To say that an alternative presupposes international co-ordination, and can no longer be based on a national, or any kind of a spatially-restricted, response, a proposition which some radicals advance, is inadequate: it amounts de facto to conceding that a feasible alternative to the current set of policies does not exist.
>
> It is our contentional however that a feasible alternative, not just a desirable one, to the existing policies exists. We should draw a distinction here: obviously the East Asian and the South-East Asian cases underscore the possibility of a successful, neomercantilist (and in that sense nationalist) policy response in the contemporary environment. But those cases are also marked by economies where the development of financial institutions and hence the possibility of integration with global finance are limited to start with. China's stock exchange is very recent in origin. Vietnam does not even have one to date, and even in avowedly capitalist East Asia financial interests have generally played second fiddle (except briefly in Japan). One cannot of course recreate those initial conditions (and other conditions conducive to neo-mercantilism) in India: apart from being unhistorical that is not even necessarily desirable, since neo-mercantilist strategies have been associated with politically authoritarian structures. So, in discussing an alternative we have to talk of a sui generis alternative. And the question is: is it feasible?
>
> The fallacy in our view lies in believing that an undermining of the 'control area' of the nation state is tantamount to an impossibility of intervention. What such undermining does is to impose an important additional constraint upon the nation-state; the nation state cannot certainly intervene in the old way. It can now intervene with some degree of success only if it takes this constraint into account.
>
> Specifically for economies like India this involves that the volatility of financial flows has to be kept under check through a combination of: (i) direct regulations; (ii) an overall sound balance of payments (in relative terms, which is not synonymous with neomercantilism); (iii) and, above all, through a development strategy which ensures economic advance with social stability.
>
> (i) The main form of direct regulation that we have in mind is of course a mix of capital flow controls with a non-convertible currency. External pressures against such regulation would be strong; but a country the size of India can, if she so chooses, show sufficient resilience to stand up to such pressures. After all even the current government, committed as it is to structural adjustment, has not moved towards full convertibility despite external pressures.
>
> The real problem, it may be thought however, would be of a different kind; globalization of finance is such a strong process that direct regulation may prove ineffective in stemming illicit flows. But to believe that the existence of regulations makes no difference to the behaviour of economic agents is fallacious. And the effectiveness of regulations depends upon the character, and hence the social basis, of the state (a proposition which must not be confused with the view that an authoritarian state regulates more effectively; indeed we argue the contrary). The alternative we have in mind is not confined to merely having regulations by the extent state, but encompasses, as well shall see, a change in the character of the state.
>
> (ii) Regulations, however, have to be backed by a sound balance of payments position through a sound trade performance. A part of the key to such a sound trade performance lies in the imposition of intelligently-devised import controls; at the same time, however, a sound export performance is essential. While the importance of boosting exports is stressed by neoclassical economists, they never distinguish between primary commodity and manufacturing exports. In agriculture, as already mentioned, private investment is predicated upon public investment; and if the latter cannot be augmented, either because the system is already agricultural-supply-constrained pace Kalecki (and hence up against the inflationary barrier), or because the state is being made to withdraw from its inventing role, then an increase in agricultural exports necessarily means a lower profile of domestic availability, which has the effect of both impoverishing the domestic working masses, as well as contracting the home market for manufactured goods.
>
> Manufacturing exports, however, as Kaldor had argued long ago, are in an altogether different category. To the extent that investment decisions here are induced by larger capacity utilization, larger exports provide both the inducement as well as the material wherewithal (from the supply-side) for larger investment. Manufacturing exports in other words can provide the basis for a self-sustaining growth-process in a way that agricultural exports (except under special circumstances) cannot. The history of colonial India provides ample evidence for this proposition: the last half-century of colonial rule saw both a stagnant per capita agricultural output and a rise in the proportion of exports out of it, resulting in a sharp decline in the per capita availability of foodgrains, from about 200 kg per year at the turn of the century to about 150 kg at independence.

An alternative development strategy therefore must specifically aim at increasing the exports of manufactured goods. And this requires not 'getting prices right' in some neoclassical sense, but above all high rates of investment which increase the flexibility of the economy's response to the changing international environment. The correlation between high investment ratios and high export growth rates in cross-country data relating to a host of underdeveloped countries is strong. The direction of causation is always seen to lie from exports to investment; but a mutuality of causation is much more plausible in which case it is not exports which need be the initial intervention variable but the investment ratio itself.

(iii) This brings us to the main issue, namely, the alternative development trajectory. Any meaningful development strategy for India, it seems to us, must aim to bring about an immediate improvement in the living conditions of the working masses, especially in the rural sector, i.e. the modus operandi of the development strategy itself must be such an improvement in their living standards. This is not merely an ethical proposition, but a practical necessity, both for the preservation of meaningful democratic structures, as well as for arousing the kind of enthusiasm and participation among the masses on the basis of which alone the structures of a more accountable state, a state capable of imposing discipline upon the rich and the capitalists, can be built. Such an immediate improvement must have as its cornerstone an accelerated agricultural growth based on egalitarian land reforms. The East Asian example has shown the importance of land reforms even for a neomercantilist strategy of economic nationalism: indeed it is important for any national economic programme. The Chinese example has shown the vigour of an industrialization drive based on an expansion of mass markets deriving from an accelerated agricultural growth. In their specific context, at the present conjuncture, this growth has been achieved through a break-up of communes though on the basis of the groundwork, e.g. the destruction of landlordism and the erection of water-management systems, prepared earlier. In India at the present conjuncture accelerated and dispersed, i.e. not regionally concentrated, agricultural growth requires the institution of land reforms.

Together with land reforms of course a number of complementary areas have to be dealt with such as irrigation and water management, rural infrastructure, literacy, sanitation and drinking water, etc. All these would require considerable investment, but investment that is best undertaken under the aegis of elected local-level bodies. The requirement therefore is also for a devolution of resources and decentralization of planning. But the resources themselves have got to be raised and there is no escape from heavier doses of direct taxation, of property at any rate if not of incomes (though tax evasion in the latter case has to be stopped through punitive action). It is here that the conflict between the strategy just advocated and 'marketism' becomes apparent. It is often argued by 'marketists' that they are all for rural development. But if tax concessions have to be doled out to entice capital to stay in the country, if food prices have to be raised for the surplus food producers (who happen to be the rural rich) while food subsidies are cut, if all talk of land reforms is eschewed, if financial reforms do away with any stem and earmarking of credit, and if even infrastructural development like power becomes the responsibility of the private sector, especially foreign capital, with profitability being the main consideration, then there is no scope left for an improvement in the conditions of the rural poor, or for rural development generally.

It is not enough, however, that an alternative programme exists; it is not even enough that one can identify in the abstract the class forces that are potentially capable of providing the social support for the implementation of such an alternative programme. These forces must be concretely ready for mobilization behind such an alternative. The concrete conditions for praxis in other words must exist; and in our view these conditions are rapidly ripening in the Indian context.

The early euphoria generated by tack of a 7–8 per cent growth rate after the 'marketist' economic reforms has vanished; the belief that the so called withdrawal of the state would be followed by a less corrupt, less arbitrary, more rule-governed order has also vanished. In short the credibility of the new policy-regime in the civil society at large has suffered greatly. At the same time there are very strong and unmistakable pressures from below for a betterment in living conditions, pressures that sometimes find outlets in the refracted form of 'lower caste' demands, and are often contained through so called 'populist' measures. The fact, however, that even the ruling party which is committed to structural adjustment is forced to undertake these very 'populist' measures frowned upon by the Fund and the Bank, is indicative of the pressures from below for an improvement in living conditions (which does not of course nullify the observations about increasing poverty made earlier).

The only way these pressures can be met is if the basic classes, viz. the workers, both organized and unorganized, and the bulk of the peasantry, make the alternative programme into their own. If large DFI inflows are precluded, then the only means of improving the living conditions of the mass of the people is by tapping the existing reserves of the economy, i.e. by taking up the slack in agriculture through egalitarian land reforms as well as by more investment in rural infrastructure, and by raising the domestic savings ratio as the East Asians and South-East Asians have done. True, this appropriation of an alternative programme would take time, but the conditions for it are ripening.

We shall end with two comments. An essential component of any alternative programme over and above the mere nitty-gritty of an economic strategy must be a strengthening of democratic institutions and structures. Only then would its appropriation by the basic classes be a productive and more durable one. In other words what is essential is not a new bout of social engineering, but a genuine process of social transformation which expands the direct political intervention capacity of the basic classes. Much has been written on the state-versus-market dichotomy, and much of it, as we have seen, is facile. If the state is not sufficiently accountable to civil society, then it has to be made accountable; but this cannot be ensured merely by a formal change in its character. Such a formal change has to be accompanied by a substantive expansion in the capacity for direct intervention on the part

of the very classes in whose favour the formal change in the character of the state is supposed to have occurred. Putting it differently, the state-versus-market debate is a red herring which sidetracks the real debate—greater or lesser democracy for the broad masses of the people.

The second comment is the following: the fact that globalization of finance has made the pursuit of progressive economic policies more difficult is obviously undeniable. But, in focusing upon this phenomenon exclusively, we run the risk of missing the dialectics between the external and the internal, of completely ignoring the possibility of domestic mobilization, of ignoring the effect of this mobilization upon the ability to tackle the external constraints, in short of ignoring the 'totality' of the situation which defines the scope for praxis. Into the constitution of this 'totality' what enters is not only the changes occurring at the level of world capitalism, but also the level of political mobilization of the masses domestically.

Source: Patnaik, Prabhat and C. P. Chandrasekhar, 'Indian Economy Under "Structural Adjustment"', *Economic and Political Weekly*, vol. 30, no. 47, 1995, 3010–12.

NOTES

1. This section draws heavily on the paper by Arshad Zaman, 'The Government's Present Agreement with the IMF: Misgovernment or Folly?', *Pakistan Journal of Applied Economics*, vol. 11, nos. 1 and 2, 1995.
2. SDRs, or Special Drawing Rights, are the IMF's 'currency', based upon a weighted basket of the main currencies in world trade. This basket is supposed to ease the volatility in any single currency.
3. Zaman, Arshad, op. cit., 82, Footnote 8.
4. Ibid.
5. Ibid., and Zaidi, S. Akbar, 'The Structural Adjustment Programme and Pakistan: External Influence or Internal Acquiescence?', *Pakistan Journal of Applied Economics*, vol. 10, nos. 1 and 2, 1994.
6. State Bank of Pakistan, *Annual Report, 2001–02*, Karachi, 2002, 168–9.
7. The 1993 loan, as has been argued, was a precursor to the extensive EFF/ESAF loans of 1994. For our analysis we refer only to the 1994–7 period.
8. Readers are encouraged to study Appendices 15.1 and 15.2 in the second edition of this book to examine details of the earlier agreements, and also to observe, that the new PRGF agreement is primarily a continuation and extension of the earlier ESAFs of 1988 and 1994—see also Appendix 17.1.
9. See World Bank, *Pakistan: Medium term Economic Policy Adjustments*, Report No. 7591-Pak (Washington DC, 1989), 31.
10. This section is based on the World Bank's analysis of the 1988 Structural Adjustment Programme. See World Bank, *Pakistan: Country Economic Memorandum FY93*, Report No. 11590-Pak (Washington DC, 1993).
11. Ibid. 35.
12. McCleary, William, 'Pakistan: Structural Adjustment and Economic Growth', in V. Thomas et al. *Restructuring Economies in Distress*, (New York: Oxford University Press, 1991), 432.
13. Ibid. 433.
14. Khan, Mohsin, S., 'Comments', in V. Thomas et al. op. cit., 1991, 439.
15. Khan, Shahrukh Rafi, 'Testing Hypotheses and Assessing Impact of Structural Adjustment: The Case of Pakistan', Sustainable Development Policy Institute, Monograph No. 6, Islamabad, 1997, 144. Also see Khan, Shahrukh Rafi, *Do World Bank and IMF Policies Work?* (London: Macmillan, 1999).
16. Kemal, A. R., 'Structural Adjustment, Employment, Income Distribution and Poverty,' *Pakistan Development Review*, vol. 33, no. 4, 1994.
17. See, Zaidi, S. Akbar, op. cit., 1994.
18. Nabi, Ijaz and Naved Hamid, 'The Aid Partnership in Pakistan', in Lele, M. and Ijaz Nabi, *Transition in Development: The Role of Aid and Commercial Flows* (San Francisco: ICEG Press, 1991), 53.
19. Ibid. 55.
20. Ibid.
21. Ibid. 64.
22. Tybout, J. R., 'Industrial Performance: Some Stylized Facts', in V. Thomas et al. op. cit., 1991, 157.
23. V. Thomas et al. op. cit., 1991.
24. McCleary, op. cit., 1991, 421, emphasis added.
25. Reed, David, *Structural Adjustment and the Environment* (Boulder, Colorado: Westview Press, 1992), 39.
26. Banuri, Tariq, 'Just Adjustment: Protecting the Vulnerable and Promoting Growth', *Pakistan Development Review*, vol. 31, no. 4, 1992, 681.
27. *The Economist*, London, 30 October 1993, 48.
28. See, Hasan, Arif, 'The Unresolved Conflict', *DAWN*, Magazine, 13 March 1992.
29. Ibid.
30. Zaman, Arshad, 'Sustainable Development, Poverty and Policy Adjustments: Linkages and Levers of Change', mimeo (Toronto: International Institute of Sustainable Development, 1993), 7.

18 Macroeconomic Developments: 1998–2013

This chapter examines Pakistan's macroeconomic developments over the period 1998–2013, with a focus on three phases. The first phase covers the period 1998 to around 2004, (see Chapter 16 in *Issues* (Second Edition), from where the discussion in this chapter is retained. The second phase, examined in Section 18.6, covers the period of the second half of the General Musharraf-Shaukat Aziz government, from around 2004 to the beginning of 2008, with a comment on the Caretaker government of November 2007 to March 2008, which was still headed by General Pervez Musharraf as President of Pakistan. The third phase, examined in Section 18.7, is the macroeconomic policy of the Pakistan People's Party government, from 2008 to early 2013.

The first sentence of the *Pakistan Economic Survey 1998–99* of the Government of Pakistan, released in June 1999, stated that 'the outgoing fiscal year 1998–99 has been the most difficult and challenging year for Pakistan's economy'.[1] The *Annual Report* of the State Bank of Pakistan for 1998–99, released in December 1999 under radically different circumstances, concurs and begins with almost exactly the same statement: 'The year 1998–99 was one of the most difficult years in the history of Pakistan'.[2] Not only was the analysis of the past year in both these documents interesting given the numerous political developments that had taken place in Pakistan during the course of the fiscal year (which ran from July 1998 to June 1999), but what was even more interesting, was that in the space of the six months in which these two reports were released (June and December), the government which was responsible for the first document (the Pakistan Economic Survey), had been forcibly removed from office through a military coup, and the second document (the State Bank Annual Report), was produced by a completely different set of people. Yet both reports concurred that the period 1998/99 was the 'most difficult year for Pakistan's economy'.

Almost every year, during the six year period 1998–2004, was critical and meaningful, if not dramatic, in the context of political and economic developments within Pakistan and also internationally, which subsequently had a major impact on the country—see Box 18.1. This chapter reviews the economic consequences of numerous such political and diplomatic events. In the previous two chapters we examined developments in the economy in light of the IMF and World Bank policy for Pakistan, and argued that for the most part, despite the numerous changes in governments since 1988, the economic policies were quite similar. In the period after 1998, the economic policy continued on the IMF/World Bank path, but was further enforced and deepened, especially after General Musharraf took over in October 1999, with a new economic team based on bureaucrats and bankers from the World Bank, IMF, and Citibank. However, due to the nature of non-economic developments in the period after 1998, extraneous developments have also had a very significant bearing on economic developments in Pakistan— see also Chapter 25.

Despite the fact that in each of these six years, there have been one or two quite significant developments, this chapter does not discuss each year separately. Rather, it looks at some of the important issues, processes and developments that have taken place in the economy on account of these events. We examine the impact of the 1988 nuclear tests, of 9/11 and its consequences, the debt crisis and debt rescheduling, the increase in foreign exchange reserves, and other issues including the question of stabilization and growth. However, before we examine developments after 1998, it would be useful to quickly get an overview of the state of the economy prior to this period, particularly during the 1990s, and then examine subsequent events in light of the earlier trends—see also Chapter 22 which looks in detail at Poverty, a phenomenon which emerged so dramatically in the 1990s.

18.1 Before and After May 1998

Although both the State Bank of Pakistan *Annual Report* of 1998/99 and the *Pakistan Economic Survey* of the same year believe that this year was one of the most 'difficult' in Pakistan's history, it was certainly not one of the worst, in terms of economic indicators. In fact, as Table 18.1 shows, that in terms of GDP growth, 1998/99 was far better than the two previous years and the three subsequent years, although no one will deny that after 1998, the situation did deteriorate due to the developments of 1998. In fact, the growth rate for 1998/99 was only marginally lower than the average for the preceding eight years 1990–98.

Although the May 1998 nuclear tests did have major consequences on the economy, as we discuss below, the economy prior to 1998, cannot be claimed to have been doing very much better. In fact, we argue in Chapters 16 and 17, and also in Chapter 22 on Poverty, that the nineties as a whole were the decade of under developing Pakistan, especially when compared to the 1980s. This, we argue, was on account of the policies implemented on the advice of the IMF and the World Bank, especially at a time when the debt from the 1980s, had become quite severe. Not only were the policies of the IMF and World Bank quite disastrous, but

Box 18.1

1998–2004 Key Events

These are mainly political developments and the economic repercussions are discussed in the main chapter.

May 1998	Both India and Pakistan test nuclear devices.
February 1999	Prime Minister of India, Atal Behari Vajpayee visits Pakistan and the Lahore Declaration is signed.
May/June 1999	The Kargil War takes place between India and Pakistan.
October 1999	The democratically elected government of Nawaz Sharif is dismissed by a military coup led by General Pervez Musharraf who proclaims himself Chief Executive of Pakistan. Pakistan is ostracized for the military coup and doing away with democracy.
April 2000	General Pervez Musharraf holds a referendum which is considered to be most controversial by the local and international media, which proclaims him President of Pakistan for five years.
July 2000	General (now also President of Pakistan) Pervez Musharraf visits India for the Agra Summit with Indian Prime Minister; Summit is a failure.
11 September 2001	'The day the world changed', as two planes crash into the Twin Towers in New York. The US begins bombardment and subsequent occupation of Afghanistan and the Taliban government annihilated or captured. Pakistan becomes front line state again, this time in the War Against Terror rather than in the War against Communism and Soviet Expansionism, as it did in 1979. Pakistan welcomed back into the community of nations.
December 2001	Attack on the Indian parliament in Delhi; Pakistan and India engage in diplomatic war, with over a million troops placed on the border in an eyeball-to-eyeball position. South Asia, 'the most dangerous place in the world', with the two nuclear powers threatening war, becomes a no-go-area for foreigners and foreign investment. Tensions ease only in 2003.
October 2002	General Elections held in Pakistan with a Parliament emerging and electing a Prime Minister; General Musharraf stays on as President on the basis of a controversial Referendum held in April 2000 which declared him President for five years.
March 2003	The US-led 'Coalition Forces' invade Iraq. Pakistan continues to play key role in the War against Terrorism.
April 2003	Indian Prime Minister Vajpayee offers hand of friendship to Pakistan to resume talks again.
December 2003	The Seventeenth Amendment to the Constitution of Pakistan (part of the contentious Legal Framework Order) passed by Parliament, and agreement reached with a section of the opposition (the religious alliance, the Muttahida Majlis-e-Amal); General Musharraf's presidency endorsed by the House, while the opposition continues to question his right to be President.
January 2004	The Twelfth SAARC Summit held in Islamabad with the South Asia Free Trade Agreement (SAFTA) agreed to. India and Pakistan agree to keep meeting and discussing issues and trying to establish peace in South Asia.
July 2004	Prime Minister Zafarullah Jamali resigns his post and a new Prime Minister instated. The hidden hand of the forces that be, continues to determine politics in Pakistan.
September 2004	Finance Minister Shaukat Aziz elected Pakistan's Prime Minister.

the way they were implemented by different governments, the timing, sequencing, and speed of the reforms, were also responsible for the poor performance of the decade of the 1990s. Nevertheless, the May 1998 nuclear tests did have a major significance for events but, as has happened so many times in Pakistan's history, soon after, other events turned out to be quite fortuitous for Pakistan, wiping out somewhat the losses incurred as a consequence of the nuclear tests.

Soon after the nuclear tests, the developed countries, the G-8, imposed a wide range of economic sanctions against Pakistan. The Japanese, for example, because of having experienced the outcome of nuclear lunacy, do not do business with any country which conducts nuclear tests. As a consequence, the Japanese government (which, it must be emphasized, was Pakistan's largest aid donor and important trading partner) stopped all funding of projects and aid, both to India and to Pakistan. Other governments also castigated Pakistan (more so than India, which was also in the firing line) for undertaking nuclear tests and cut aid and assistance on which the Pakistani economy and

Table 18.1
Key Economic Indicators: 1990–2010

Year	GDP Growth Rate	Agriculture Growth Rate	Manufacturing Growth Rate	Growth Rate in Total Investment	Inflation CPI	Fiscal Deficit % of GDP	Growth in Exports	Population Below Poverty Line	Remittances in US$ million	Fixed Investment as % of GDP
1980s avg	6.5	5.4	8.2	-	7.2	7.1	8.5	17.32*	-	17.0
1990/91	5.6	5.0	6.3	19.4	12.7	8.8	19.8	22.11	1,848	17.4
1991/92	7.7	9.5	8.1	26.2	10.6	7.5	14.6		1,467	18.5
1992/93	2.1	–5.3	4.4	13.8	9.8	8.1	0.3		1,562	19.1
1993/94	4.4	5.2	4.5	10.0	11.3	5.9	–1.4		1,445	17.9
1994/95	5.1	6.6	2.5	13.4	13.0	5.6	16.1		1,866	16.9
1995/96	6.6	11.7	3.7	16.4	10.8	6.5	7.1		1,416	17.2
1996/97	1.7	0.1	–0.1	8.0	11.8	6.4	–2.6	31.00	1,409	16.2
1997/98	3.5	4.5	6.9	9.0	7.8	7.7	4.2		1,489	14.7
1998/99	4.2	1.9	4.1	–3.6	5.7	6.1	–10.7		1,061	13.9
1999/00	3.9	6.1	1.5	10.2	3.6	6.6	8.8		983	14.4
1990s avg	4.5	4.5	4.2	12.3	9.7	6.9	15.6	26.6	1,455	16.7
2000/01	2.2	–2.7	8.2	5.5	4.4	5.2	9.1	32.60	1,086	13.9
2001/02	3.4	–0.1	5.0	0.4	3.5	5.2	2.3		2,389	13.1
2002/03	5.1	4.1	7.7	16.2	3.3	4.6	16.6		4,236	13.1
2003/04	7.5	2.4	14.0	14.4	4.9	3.7	10.3		3,872	15.3
2004/05	9.0	6.5	15.5	32.6	10.4	2.3	16.9	23**	4,169	17.5
2005/06	5.8	6.3	8.7	36.1	9.7	3.3	14.3		4,600	20.5
2006/07	6.8	4.1	8.3	15.7	10.2	3.1	3.2		5,494	20.9
2007/08	7.2	1.0	4.8	15.6	17.0	4.4	12.2		6,451	20.5
2008/09	3.6	4.0	–3.7	6.9	17.0	7.6	–7.2		7,811	17.4
2009/10	4.4	2.0	5.2	0.7	11.8	5.2	9.1		8,906	15.0
2000s avg	5.5	2.8	7.4	14.4	9.2	1.2	8.7	27.8	4,901	16.7

^{P} = Provisional
From 2007–08 base year = 2007/08 = 100 for CPI Inflation
Source: ** 2002–05 Human Development in South Asia 2011.
Source: State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010* (Karachi: SBP, 2010).

government had become most dependent. The sanctions imposed by the US President under the Glenn Amendment included the following: the termination of US foreign aid programmes except for humanitarian assistance and food or other agriculture commodities; the denial of export credits and guarantees by any US department or agency; the termination of sales of defence articles and defence services and termination of all military financing; the opposition to the extension of any loan for financial or technical assistance by any international institution such as the Asian Development Bank, the IMF, and the World Bank; and the prohibition to US banks from making any loans to the Government of Pakistan. Not surprisingly, the IMF also suspended its Enhanced Structural Adjustment Facility (ESAF) and the Extended Fund Facility (EFF) programmes as well as new Official Development Assistance. On all fronts, Pakistan was squeezed by the western donors and governments as a consequence of undertaking these nuclear tests—see Box 18.2 on some estimates of what the nuclear tests cost Pakistan. The State Bank of Pakistan *Annual Report* for 1997/98 summarized the issues as follows:

> Developments in May, 1998 had a major impact on balance of payments, net foreign assets of the banking system, stock market and the exchange rate. The nuclear blast by India immediately affected the investors' confidence and the stock market declined, free market exchange rate depreciated, and foreign currency deposits were

Box 18.2

What did the Nuclear Blasts/Sanctions Cost Us?

We are now in a position to make a summary assessment of that the nuclear blasts and sanctions have cost the people of Pakistan, even after the apparent bail-out by the IMF and other multilateral agencies through enhanced external assistance and debt rescheduling. The table below gives the estimates of the magnitudes of different costs. First, the average household will lose Rs. 400 annually (at 1980–81 prices) in the short run which will rise to about Rs. 1600 in the next five years. Almost Rs. 13 billion will be lost from the GDP in the short run and over Rs. 40 billion by 2002–03.

Employment opportunities are expected to be reduced by over half a million annually in the next five years. Almost 2 million more people could fall below the poverty line in the short run, with the number rising rapidly to over 5 million by 2002–03. Rising food prices and lower incomes, along with contraction in preventive health services such as immunization programs, will exacerbate the problem of the high proportion (over 40%) of malnourished children in Pakistan. Almost 400,000 additional children could be adversely affected in terms of their nutritional status. Lower income growth and a tight labour market will diminish the prospects for a rapid improvement in the status of women.

Altogether, Pakistan will pay a significant price for the acquisition of nuclear capability in the face of international sanctions. It will take time for confidence and growth momentum to be restored, even with the IMF program. Of course, it can legitimately be argued that this is the minimum price a nation is willing to pay for its national security and that Pakistan is today a stronger nation with greater international recognition. It is essential, however, to recognize that, irrespective of the magnitude of costs, these must be distributed equitably. The standard of living of poor people must decline the least, through resort to appropriate macroeconomic policies and the development os social safety nets.

SHORT RUN (First Year)	LONG RUN (Fifth Year)
• Lower Gross Domestic Product by Rs. 12 billion*	• Lower Gross Domestic Product by Rs. 41 billion*
• Lower real per household income annually by Rs. 400*	• Lower real per household Income annually by Rs. 1600*
• Lower consumption expenditure by Rs. 17 billion*	• Lower consumption expenditure by Rs. 43 billion*
• Lower employment by 80,000	• Lower employment by 740,000
• 16,000 more educated unemployed	• 200,000 more educated unemployed
• 2,000,000 more persons below the poverty line	• 5,000,000 more people below the poverty line
• 400,000 additional malnourished children	• 480,000 additional malnourished children

* valued at constant prices of 1980–81

Source: Social Policy and Development Centre, *Social Development in Pakistan: Annual Review 1999* (Karachi: Oxford University Press, 1999), 58–59.

> withdrawn significantly during 11–28 May 1998. Pakistan's response on 28 May 1998 to the Indian detonation, followed by economic sanctions by the United States, and a restraining stance adopted by the G-7 countries with regard to the lending by the international financial institutions, further contributed towards the erosion of confidence and weakening of the budget and the balance of payments.[3]

Nevertheless, one specific action by the Government of Pakistan was probably more responsible for starting a domino effect than anything else.

While the nuclear tests were bad enough, the freeze on Foreign Currency Accounts (FCAs) soon after made matters far worse and caused major problems. Since January 1973, Pakistanis living overseas were allowed to open bank accounts in Pakistan holding certain types of foreign currencies. The purpose of this scheme was to allow the government to capture some of the vast amount of foreign exchange earned and held by the large number of Pakistanis working overseas. In 1991, even resident Pakistanis were allowed this privilege, and many bought dollars and other currencies and held them in Pakistani banks in Pakistan. Pakistan has a large underground/black/illegal sector, and it is estimated that at least 40–80 per cent of its GDP equivalent is held in the black economy. An additional assumption is that many Pakistanis have promoted capital flight keeping legal and illegal income abroad. In order to address these issues and to attempt to reverse capital flight, governments in Pakistan encouraged resident Pakistanis to keep foreign currency at home. This led to speculation on foreign currencies and to the 'dollarization' of the economy, where anyone who had any legal or ill-gotten wealth, immediately purchased dollars and deposited them into their resident Foreign Currency Accounts FCAs. This quest for dollars kept a constant pressure on the exchange rate, pushing it up to artificially high levels, causing the rupee to devalue which had numerous other repercussions on the economy.[4] The rates of return on foreign currency deposits were exempt of income tax and *zakat*, and were 'considerably higher than for rupee financial assets . . . and this has been one of the most important factors leading to dollarization'.[5] Add to this the high inflation prevalent in Pakistan at that time and steady depreciation of the rupee, and you have an asset which should have been secure and guaranteed higher returns than any other. Perhaps that is why, by May 1998 around $11 billion had been deposited into Pakistani banks by resident and non-resident Pakistanis.

The Indian nuclear tests were conducted on 11 May and until 28 May when Pakistan conducted its own test, some foreign currency was withdrawn. Fearing a run on the rupee, and that Pakistanis would rush to withdraw their deposits, the government of Nawaz Sharif, put a freeze on withdrawals not allowing the deposit holders to withdraw their own money. The government justified this action as follows: 'The past experience had shown that in a period of uncertainty, foreign currency deposits begin to be withdrawn and it was apprehended that it could take place on a large scale and sustained basis in the post 28 May period'.[6] This caused what is for sure, Pakistan's greatest crisis of confidence, and all the trust that had been accumulated over many years, was lost by this one gesture.

It was probably this measure, more than any other, which made the Nawaz Sharif's government very unpopular. Perhaps his government overreacted and should have had more confidence in its policies and promises, but it seems, after all, that the cupboard was bare. The government knew that the actual level of foreign exchange reserves was much lower than the $11 billion it should have had, and had the run taken place, it would not have been able to meet its liabilities. The consequence of imposing the freeze was such that in six weeks, at the end of the fiscal year in June, the stock market was down by 37.6 per cent, and more importantly, the free market exchange rate of the rupee, had depreciated by 16.2 per cent and liquid foreign exchange reserves had declined to a mere $423 million, a fraction of the liabilities. The crisis of confidence had a particularly strong impact on investors, both local and foreign, and with sanctions imposed, and credit ratings very low, the general trend was most unfavourable towards the economy. Following their earlier experience, it is improbable that a government which has real, liquid, foreign exchange cash worth $12 billion, as the government in 2004 did, would promote a scheme such as that of allowing residents to open Foreign Currency Accounts. More importantly, even if the government were to announce such a scheme, it is improbable that there would be many takers. Trust once lost, in this case even by the hands of an earlier government, is very difficult to regain.

An observation that emerges from our evaluation of one of the most important interventions made by the Nawaz Sharif government in its second tenure, that of freezing FCAs, has interesting political economy implications. Table 18.1 shows that high levels of poverty had already started emerging well before 1998; developments after May 1998, surprisingly, did not have a serious poverty-enhancing effect since poverty levels from the mid 1990s more or less remained at that level. Given the impact of the freeze on FCAs and other developments in the economy, their repercussions should have acted on increasing poverty levels. The FCAs were held by well-to-do and middle class Pakistanis, not the poor. This perhaps confirms the nature and existence of the dualistic (perhaps even, enclave) economy in Pakistan, where such a drastic measure by the government, affected largely a section of the better-off and the (negative) results did not filter down to the entire population. For much of the 1990s, this middle class had been the main supporter of Nawaz Sharif, and perhaps due to this one measure in which they were hit hardest, they did not come to his defence when General Musharraf's coup took place 16 months later—see Chapter 26 and 27.

18.2 11 September 2001: The Day the World Changed

After May 1998, when it became clear that Pakistan had nuclear capability, a known secret since at least 1986, Pakistan, not so much India, became a pariah state. While sanctions continued and as Table 18.1 shows, the economy

after 1998 slowed down, numerous developments in 1999 made that year one of the most remarkable in Pakistan's 57 year history—see Box 18.1.

In February 1999, Indian Prime Minister Atal Behari Vajpayee made, what at that time was thought to be, an historic trip to Lahore and with the Prime Minister of Pakistan, Nawaz Sharif, signed the Lahore Declaration, trying to take both countries, now open and acknowledged nuclear states, towards the road to peace. Prospects of trade and better relations seemed to be on the horizon, but more importantly, there was a feeling that perhaps peace would become a priority for both nations. However, the peace process was quickly derailed by the Pakistan military's huge misadventure in Kargil, which cost both Pakistan and India not just many hundreds of lives, but also destroyed any hope for peace and wrecked the trust that had been built just a few weeks earlier—for further reading see the chapters in Part IX of this book.

While the first half of 1999 consisted of these two extremes of peace and war, in October 1999, the democratically elected government of Nawaz Sharif was dismissed by General Pervez Musharraf in Pakistan's third coup. As it was, Pakistan was being considered a rogue state for testing its nuclear devices, the re-entry of the military into government after a lapse of eleven years, did not improve Pakistan's image at first. Some further sanctions were imposed on the country, and as Table 18.1 shows, the economy was staggering. However, all that changed after 9/11.

It was not just the twin towers in New York that crashed on 11 September 2001, but all financial markets across the world took a huge dive over the next few days. The western capitalistic countries, who are so dependent on their stock markets for cash and as a symbol of the economic situation, went further into a slump which had begun sometime at the turn of the new millennium. 9/11 and its contagion effect pushed these markets and these economies further into recession like conditions and it took around eighteen months to two years for the economies to gain some of their lost ground. With the US economy dominating the new era of world trade and globalization, the slowdown in the US economy resulted in a worldwide slowing down and very sluggish growth.

Pakistan had enough political and economic problems prior to 9/11. The nuclear test related sanctions were still in place, democracy had been overthrown by a military coup, Pakistan's debt burden was still huge and as Table 18.1 shows, the downturn in the economy had already set in prior to 9/11. There were two sets of major factors related to 9/11, which were related to Pakistan's economic future.

The first set included issues which emerged as a response to the world economic growth slowing down more generally. This meant that with world growth slowing down, so would demand for world exports into the developed markets. Consumption and incomes fell in developed countries, and so did imports from other countries. Moreover, there was a sense of shock and insecurity, which meant that Americans were less enthusiastic to spend and were holding back. Second, there was a huge fear of Muslims, Islam, and people from other, particularly Middle Eastern, countries. Pakistan was also included in this category, so most US businesses and firms, treated Pakistanis and Pakistan with distrust, if not with out and out suspicion. This meant that foreign investors would not be willing to invest in Pakistan nor even visit possible exporters and markets in the country. Travel advisories were issued which persuaded US and other western businessmen not to visit places like Pakistan. Moreover, with the US bombardment of Afghanistan in order to annihilate members of the Taliban regime, in which Pakistan played a key role, Pakistan became the backyard of the US' war against terror and its war in Afghanistan. The backlash of this action was that many suspected al-Qaeda members and former Taliban members found refuge in Pakistan, causing Pakistan to be further blacklisted. By all accounts, Pakistan was a 'no go' area for foreigners, particularly Americans, whether they were donors or businessmen. In addition, many countries were no longer eager to deal with Pakistani businessmen and as a consequence, industry suffered.[8] This was the first and most immediate consequence on Pakistan's economy. However, as Pakistan once again became a front-line state, circumstances changed once again, and this time very fortuitously.

With the Government of Pakistan very quickly throwing in its lot with the American's in their War Against Afghanistan, and in the all out War Against Terror, the immediate negative costs and complications were those mentioned above, many of which continue to this day—see Chapter 25. Nevertheless, in the medium and longer term, there were dramatic changes, particularly for the military government of General Musharraf. From being labelled a rogue Islamic state with nuclear pretensions, General Musharraf was welcomed back into the comity of civilized nations fighting the War Against Terror. Overnight, he became the darling of the West, with dozens of leaders and dignitaries from the developed countries visiting him in Islamabad. While this ensured his political longevity at least for some time, the economic returns of siding with the Americans were unprecedented. The first thing that happened—in fact as early as on 23 September 2001—was that President George Bush waived key sanctions against India and Pakistan which had been imposed after the May 1998 nuclear tests. For Pakistan, the lifting of sanctions meant, most importantly, that the United States could now vote in favour of multilateral aid packages, particularly the Poverty Reduction and Growth Facility which the government was negotiating with the IMF at that time—see Box 18.3 which shows that just a few days prior to 9/11, the US government was not at all keen in supporting Pakistan's request for the IMF Poverty Reduction and Growth Facility; all those reservations evaporated after Pakistan's agreed to side with the US.

The biggest problem that had plagued Pakistan's government for many years since the profligate 1980s under General Zia, was that of excessive and growing debt (both domestic, but particularly international) and annual interest payments—see Section below. Pakistan's economy was struggling under debt, equivalent to its GDP, with half being foreign debt. As a return for Pakistan's support to the US in particular and the West in general, huge amounts of debt were either written off, or rescheduled under very

Box 18.3

Political Factors and IMF Loans

This edited extract from an article by Ihtasham ul Haque just two weeks before 9/11, shows that numerous political factors existed before the loan could have been approved. However, all that changed after 9/11.

The joint review of the performance of the economy by the World Bank and the IMF is being conducted these days to assess whether Pakistan qualifies for new $2 to 2.5 billion funding under the Poverty Reduction Growth Facility (PRGF) after the expiry on 30 September, of the ongoing $596 million Standby Arrangement (SBA).

Why a joint review, when the new funding line is being sought from the IMF which according to finance minister Shaukat Aziz, is by and large satisfied with the pace of reform except in case of revenue shortfalls that occurred in the last financial year? Representatives of the donor agencies in Islamabad and the officials of the ministry of finance have started conceding privately, that it might not be that easy to acquire a new funding line on relatively low interest rates from the IMF. They say that there 'is a set of political and economic conditionalities' that has to be met by the government for seeking the PRGF, which, if not offered, could delay the over $3 billion dollar restructuring of debt by the Paris Club this year.

What had transpired between US Assistance Secretary of State, Ms Christina Rocca and senior Pakistani officials, including the finance minister, when she visited Islamabad recently? Pakistan is believed to have been told, in so many words by Ms Rocca, that G-8 countries have their own point of view in respect to lifting the remaining international sanctions against Pakistan and extending bilateral funding.

People close to the finance minister say that political conditions have to be taken into account by the government to satisfy the G-8 countries led by the United States. They say that there might not be any difficulty in getting the last tranche of $130 million disbursed in June this year. 'But things could be tougher when it would come to having PRGF', a source close to Shaukat Aziz said. He also confirmed that the joint review of the economy involving the World Bank simply means that the IMF should not have to deal alone with Pakistani authorities. Sources in the local IMF office say that they do not see any problem in concluding a new loan agreement with Pakistan on the basis of Islamabad's meeting the broad budgetary targets by the government. 'There were some revenue slippages but then the Musharraf government enforced across the board general sales tax. Also, they succeeded in some good extent to contain the fiscal deficit which make their case pretty fine to have PRGF', he said. 'But we can not comment about political conditionalities which are apparently there'.

Pakistan had reportedly been given to understand by Ms Rocca, specially to both the foreign minister and the finance minister, that full return of democracy to be run by elected representatives, was a 'pre-condition' for a new financial package. At the same time the G-8 countries expect that President Musharraf's plan to acquire more powers by amending the Constitution should not undermine the authority of the Parliament. Pakistan was also asked to take into account the view of the Commonwealth countries about the return of democracy in the country.

Source: Economic and Business Review, *Dawn*, Karachi 27 August–2 September 2001.

easy and comfortable conditions relieving the pressure on Pakistan's foreign exchange situation. In addition, the quota for Pakistani exports to the US and the European Union was increased to compensate for earlier cancelled orders and costs. Equally importantly, was the signal to the IMF and World Bank and numerous other donors, to re-enter the field and begin supporting Pakistan again. For example, even USAID returned to Pakistan after nearly a decade, an aid agency which had exited Pakistan once nuclear related sanctions were enforced under the Pressler Amendment in the early 1990s. Pakistan was no longer 'no go' territory, and as a consequence of Pakistan's role in the war against terror and Afghanistan (and subsequently, in the US' war against Iraq, later in 2003) Pakistan's government was repaid handsomely. Another consequence was the huge increase in remittances, particularly from the US, which came to Pakistan, in 2002/03—see below. One needs to emphasize that had the New York attack not taken place, *it is quite improbable that Pakistan would have been able to get out of the post-nuclear tests and post military coup scenario, both of which had been damaging to the economy.* If one takes the narrow view of looking merely at the short-term economic view, then the dividends from Pakistan's support have been very high. However, this is a very narrow, opportunistic view which has had numerous other, consequences in the longer term—see Chapters 25 and 26.[9]

18.3 What Happened to the Debt Crisis?

Even a cursory reading of any government document or academic study by economists at any time during the 1990s, immediately reveals that Pakistan was faced with a 'crippling', 'devastating' debt crisis for the entire duration of that decade. Both external and domestic debt had reached astronomical, unsustainable, levels, as had the budget deficit and interest payments, which continued to give rise to further debt, both domestic and foreign. Add to this, the fact that the economy was doing particularly poorly in terms of investment, growth and revenue generation, and one can understand the nature of a real and growing economic crisis. The external debt and interest payments had reached such astronomical proportions—see tables—that there was

a real fear that Pakistan would default on its international commitments and be declared bankrupt, in addition to being called a rogue or pariah state. However, in December 2001, but more specifically by 2002, the external debt crisis had become, for the moment at least, forgotten and 'resolved', and the Government of Pakistan had in fiscal year 2003/04 even voluntarily retired $1.2 billion before its due date. How did this dramatic turnaround take place?[10]

In order to gauge the extent of the crisis and the gravity of the situation, it is important to know the amount of external debt owed and interest payments being made each year. Table 18.2 presents key ratios and data which give a clear picture. (Since there has been a change in how external debt is calculated by the State Bank of Pakistan—see Box 18.4 on the new calculations—Table 18.2 presents earlier data to get a picture of the extent of debt, while Table 18.3 presents data based on the new, now conventional and accepted, definitions).

Table 18.2 shows that by 1998/99, external debt was more than half the size of the GDP, and with domestic debt around the same amount as well, Pakistan's total domestic and external debt was greater than the size of the GDP. While Pakistan was paying back around a third in export earnings in the form of debt servicing, it was still adding on to the stock of overall total external debt. Clearly, this trend was not particularly helpful towards Pakistan's economy, and is one of the reasons for the very poor economic growth and social statistics during the 1990s. Our discussion in this section is based on Table 18.3, which shows the new debt figures developed by the State Bank of Pakistan as discussed in Box 18.4.

Table 18.3 only endorses the view based on the earlier table, perhaps more forcefully, that Pakistan's external debt crisis had become quite serious in the mid-1990s. The total external debt to GDP was the highest in the fateful year 1998/99 after the nuclear tests and their repercussions, with Foreign Currency Accounts very substantial; the total external liabilities to GDP ratio was also very high in that year compared to earlier years. Most figures and ratios seem to have peaked in 1998/99 after which there is a noticeable improvement. Did the reversal in the trends come about because of better management or were there other factors involved?

Pakistan has been allowed to reschedule debt on numerous occasions in the past, as Table 18.4 shows. However, the scale of rescheduling in more recent years, particularly in December 2001, largely as a payback to General Musharraf for his role backing the US in their war against Afghanistan, was extraordinary—see Box 18.5.

In January 1999, following the foreign exchange problems that had been initiated after Pakistan's nuclear tests and the freeze on Foreign Currency Accounts and the refusal of many donors to lend to Pakistan, the Nawaz Sharif government approached the Paris Club members to reschedule its public and publicly guaranteed debt. The Paris Club agreed to reschedule some of the debt service payments due for the period 1 January 1999 to 31 December 2000 in respect of the loans which were contracted prior to 30 September 1997.

Once the Paris Club agreed to reschedule the $2.744 billion repayments, the government also was given some relief from non-Paris Club bilateral creditors, and ended up with rescheduling worth $3.1 billion in this period. It was the return of the IMF to Pakistan in the guise of yet another agreement in January 1999, which allowed the rescheduling to proceed. At the end of the first consolidation period in December 2000, another round of rescheduling was sought from sovereign and commercial creditors. With the new Musharraf government in place, a Stand-By Agreement with the IMF was reached in November 2000, and in January 2001, the Paris Club, and other bilateral and commercial creditors agreed to restructure debts worth $1.8 billion.

However, the earlier debt rescheduling was minuscule compared to the $12.5 billion that took place in December 2001. Not only was this amount far larger than any such rescheduling in the past, more importantly, it was the terms of this agreement which set it apart. As the State Bank *Annual Report* states,

> The Paris Club offered very generous terms; in contrast to the previous two rescheduling agreements that provided relief *only* in terms of debt flows[11] (as per Houston terms), the existing

Table 18.2
Pakistan's External Debt Outstanding and Servicing–(Old Format) ($ m)

	Total Debt Outstanding	Growth Rates (in per cent)	Annual Debt Servicing	Growth Rates (in per cent)	Outstanding Debt as cent of GDP	Debt Servicing as per cent Export Earnings	Debt Servicing as per cent Foreign Exchange Earnings
1993/94	24,482	11.0	3,612	22.7	47.6	54.0	33.4
1994/95	25,318	3.4	4,324	19.7	41.7	55.7	34.9
1995/96	27,094	7.0	4,347	0.5	44.3	52.3	33.9
1996/97	27,863	2.8	5,083	16.9	44.7	62.8	39.3
1997/98	28,682	6.0	4,670	–8.1	48.4	55.4	34.9
1998/99	30,328	5.7	2,644	–43.4	51.7	34.9	23.0

Source: State Bank of Pakistan, *Annual Reports*, various issues, Karachi.

Box 18.4

How are Pakistan's External Liabilities Calculated?

Pakistan's External Liabilities
End FY00 (US$ million)

I. Public & Publicly Guaranteed Debt	**27,654**
A. Medium and Long term (> 1 year)	27,093
Paris Club	12,428
Multilateral	10,767
Other Bilateral	639
Eurobonds*	610
NHA Bonds	241
Military Debt*	958
Commercial Loans/Credits	1,100
Others	350
B. Short term (≤ 1 year)	561
IDB**	130
Other	431
II. Private Non-guaranteed Debt	**2,842**
A. Medium and Long term (> 1 year	2,842
Private Loans/Credits	2,842
B. Shot term (≤ 1 year)	0
III. Central Bank Deposits	**700**
IV. IMF	**1,550**
Total External Debt (I to IV)	**32,746**
V. Foreign Exchange Liabilities	**4,558**
Foreign Currency Accounts	2,349
FE 45	1,072
FE 25 Deposits	977
Outside SBP	616
With SBP (FE 13)	361
FE 31 (incremental)	300
Special US$Bonds	1,297
National Debt Retirement Program	156
Others Liabilities	756
Total External Liabilities (I to V)	
External Liabilities Payable in Rupees	**1,720**
Frozen FCAs	1,572
FEBC	109
FCBC	36
DBC	3

* Provisional numbers
** Some of these loans are > 1 & 2 < 2 year maturity.

How much exactly is Pakistan's external debt? This question has evoked a great deal of speculation, conjecture, and wild guesstimates in the press and elsewhere. The conflicting numbers that have been cited and the resulting confusion arises due to differences in coverage, and the categorization and measurement of external debt. Minor differences also arise from the use of varying rupee conversion rates. Some commentators stop at public and publicly guaranteed debts, while others include private non-guaranteed debt. Most, however, neglect obligations that have to be serviced and/or repaid in foreign exchange. The table provides a comprehensive and all-inclusive picture of Pakistan's foreign exchange obligation.

As shown in the table Pakistan's total external debt outstanding on 30 June 2000 was US$32.7 billion or 53.8 per cent of GDP. If other foreign exchange liabilities such as foreign currency accounts are added, the total external liabilities rise to US$37.3 billion or 61.3 per cent of GDP. Debt servicing on account of these liabilities amounted to US$7.8 billion or 95.9 per cent of the country's realized export earnings in FY00. As it was not possible to pay this amount fully and still meet the economy's demand for imports, more than half the contractual debt servicing had to be rescheduled (Paris Club), restructured (Eurobonds), partially paid (FE-45 deposits), or rolled-over (central bank deposits and commercial financing of imports). Contrary to popular perception, the rescheduling agreed by Paris Club creditors for FY00 was only US$1.3 billion; relief on the larger amount (US$2.6 billion) was obtained outside the framework of the Paris Club.

Of the total amount falling due in FY00, US$3.7 billion was actually paid out of the country's foreign exchange earnings and by drawing down liquid reserves. The amount eligible for rescheduling/rollover in FY01 is projected at US$2.2 billion, which is 56.4 per cent lower than the US$3.9 billion rescheduled in FY00.

Source: State Bank of Pakistan, *Annual Report 1999–2000*, Karachi, 2000, 16.

arrangement is applicable to the entire stock of US$12.5 billion of Pakistan's bilateral debt owed to the Paris Club creditors. Consequently, this provided an implied debt reduction without having a HIPC [Heavily Indebted Poor Country] status, which is generally associated with Naples terms[12].

(see also Box 18.5) Basically, the entire bilateral debt of Consortium countries has been rescheduled, and this rescheduling has been for a far longer period than in the past; Official Development Assistance (ODA) debt, which is 68 per cent of the total rescheduled, will be repayable after 35 years, with 15 years' grace period, and non-ODA debt is to be repaid over a 25 years period, with a five year grace period for other loans. Moreover, there has been a 're-profiling of the debt in such a way that it takes into consideration the country's capacity to pay'.[13] This rescheduling allowed relief of between $2.0–2.8 billion annually in payments of debt servicing on external debt during the years 2001–05 as Table 18.5 shows.[14] To put the icing on the cake, add to this the fact that Pakistan has not just had debt rescheduling, but an actual debt write-off by many friendly countries, and we have

Table 18.3a
Selected External Debt and External Liabilities Indicators

Year	TED $mn	TEL $mn	TED to GDP	TED to EE	TED to FEE	TEL to GDP	TEL to EE	TEL to FEE	DS/XGS %	RES/TEL
1980/81	-	-	35.0	360.3	-	-	-	-	-	-
1984/85	-	-	39.2	486.1	-	-	-	-	-	-
1989/90	-	-	52.6	414.2	-	-	-	-	-	-
1994/95	-	-	47.7	371.4	232.9	61.4	479.0	300.3	-	-
1995/96	-	-	47.1	358.3	232.2	61.6	695.9	451.0	-	-
1996/97	-	-	48.4	372.6	233.4	68.0	523.3	327.7	-	-
1997/98	32,080	33,840	48.5	356.5	224.9	53.7	394.7	249.1	46.0	2.8
1998/99	32,864	36,600	57.4	446.4	298.9	66.4	517.0	346.2	29.7	4.4
1999/00	32,254	37,918	53.1	395.1	252.9	62.4	464.5	297.3	31.6	3.6
2000/01	32,144	37,159	54.9	360.0	224.3	63.6	416.2	259.3	32.7	5.6
2001/02	33,400	36,532	56.6	365.7	216.1	62.1	400.0	236.4	36.7	13.2
2002/03	33,352	35,474	48.5	364.7	171.8	51.6	387.9	182.7	22.8	26.9
2003/04	33,307	35,258				36.7				29.9
2004/05	34,037	35,834	31.1			32.6			11.1	27.3
2005/06	37,229	37,265	28.0			29.2	225.0	117.0	10.0	28.9
2006/07	40,324		27.3			28.2	233.0	122.0	9.2	33.2
2007/08	46,161		27.1			28.2	226.0	124.0	8.6	
2008/09	52,331		30.5			32.2	274.0	148.0	13.2	
2009/10	57,363					31.8	283.0	146.0		
2010/11	61,844									

Source: State Bank of Pakistan, *Annual Report* (Karachi: various issues).
0.00 Debt Policy Statements
The above indicators are called Debt Sustainability Indicator, now the format and valuation of these variables have been changed, therefore, the news format is provided below.

Table 18.3b
Trends in External Debt Sustainability Indicators FY 00–FY 08

Year	EDL/GDP	EDL/FEE	EDL/FER	STD/EDL	Interest Payments/FER	Debt Servicing/GDP	Debt Servicing/FER	Total Public Debt/Revenues	EDL/Total Public Debt
FY 00	51.7	297.2	1,750.3	0.3	73.0	5.1	173.8	589	61.8
FY 01	52.1	259.5	1,146.7	0.7	41.0	7.1	157.2	631	67.6
FY 02	50.9	236.8	571.0	0.5	16.7	8.6	98.8	562.4	62.5
FY 03	43.1	181.2	329.6	0.5	8.8	5.2	40.5	501.9	56.5
FY 04	36.7	165.0	286.4	0.1	7.9	5.4	42.8	470.1	54.0
FY 05	32.7	134.3	283.8	0.8	7.2	2.7	23.5	451.5	52.6
FY 06	29.4	121.6	286.8	0.5	7.2	2.5	23.7	389.4	51.8
FY 07	28.1	124.1	267.5	0.1	7.3	2.1	19.7	370.9	51.0
FY 08	27.6	127.2	407.3	1.5	9.7	1.9	26.7	393.7	51.8

EDL= External Debt and Liabilities
FEE= Foreign Exchange Earnings FER= Foreign Exchange Reserves STD=Short Term Debt
Source: Ministry of Finance, *Debt Policy Statement 2008–2009* (Islamabad: Ministry of Finance, 2008).

Table 18.4
Amount of Debt Rescheduling in Pakistan ($ m)

1971–73	233.766
1973/74	107.166
1974–78	650.0
1977/78	226.303
1980–82	232.0
1985–88	11.0
1998/99	1987.63
1999/00	1241.70
2000/01	617.28
December 2001	12,500.00

Source: Siddiqui, Rizwana and Rehana Siddiqui, 'Determinants of Debt Rescheduling in Pakistan', *The Pakistan Development Review*, vol. 40, no. 4, Part II, 2001, 694.

an extraordinarily fortuitous situation based on Pakistan's support for the US invasion of Afghanistan and its War on Terror—see also Chapter 25.[15]

The political economy context of debt rescheduling is important to add with regard to the 'very generous terms' offered after 9/11 to Pakistan. Arshad Zaman citing numerous examples, and in particular this most recent one, argues that

> the availability of external credit—and hence the ability to incur external debt—has been determined by the status of Pakistan's relations with the US. In general, the availability of loans to the government has spiked due to regional crises and has nose-dived due to domestic developments. . . . The availability of US military and economic loans has always had a multiple effect in including bilateral and multilateral economic loans.[16]

Another bureaucrat argued that 'the economic history of various developing countries clearly shows that the disbursements of external debts and grants by the lending countries on bilateral and multilateral basis as well as rescheduling of debt are linked with political motives, economic expediencies and loan-related conditionalities'.[17] Kazmi goes on and says that 'these rescheduling events and amounts can be linked with non-economic considerations or major political events such as change of political regimes', and adds that 'incidentally, military regimes in Pakistan have generally received above average external resource inflows as well as debt reliefs [sic]'.[18]

Despite this considerable rescheduling, it is important to emphasize that Pakistan was still making substantial payments in the form of debt servicing to its creditors, as Table 18.6 shows. In 2001/02, Pakistan paid as much as $6.3 billion, equivalent to considerably more than half of export earnings—also see Chapter 11, Section 4 for more details on Pakistan's external and domestic debt.

Sakib Sherani argued that due to the factors highlighted above (also due to an increase in foreign exchange reserves) -

> the acute vulnerability associated with its [Pakistan's] account for much of the 1990s has dissipated significantly. This appears to be providing the catalyst for a significant reversal of the systemic outflows of private capital experienced in the previous decade. This phenomenon, in conjunction with substantially enhanced levels of official inflows . . . the restructuring of debt provid[ing] for reduction of at least 30 per cent in the net present value of the eligible debt stock . . . is expected to effect a significant improvement in Pakistan's debt situation in the medium term.[19]

He adds that barring any significant unanticipated deviations*, 'Pakistan's external public debt will approach sustainable levels by FY2007 [2006/07].'[20]

*Pakistan's external

18.4 The Growing Forex Reserves

While Pakistan's debt situation improved considerably after 9/11, so did the foreign exchange reserves. In 1999/2000 Pakistan's total forex reserves were $2.77 billion, which rose to $7.07 billion by the end of fiscal year 2001/02, and by June 2003 were $11.48 billion, and expected to rise even further. Moreover, in 2003/04, the Government of Pakistan was able to retire some of its foreign debt to the tune of $1 billion. While the substantial increase in foreign exchange reserves allowed Pakistan's international credit rating to improve, thus increasing further private and public inflows, the most important consequence was the stabilization and in fact, appreciation, of the Pakistani rupee. In 2001/02 the average US$/Pakistan Rupee rate was $1 equal to Rs. 61.43, which had improved to Rs. 58.50 by the end of the next fiscal year. Moreover, the difference between the official and market rates, which had always been higher, had more or less disappeared bringing both rates in line. Clearly, compared to a

Table 18.5
Pakistan's External Debt and Liabilities Servicing (New Format) ($ m)

Year	Actual paid	Rescheduled/ Rolled Over
1999/00	3,756	4,081
2000/01	5,101	2,795
2001/02	6,327	2,243
2002/03	4,349	2,795
2003/04	5,274	2,243
2004/05	2,965	1,908
2005/06	3,110	1,300
2006/07	2,978	1,300
2007/08	2,558	1,200
2008/09	3,986	1,600
2009/10	3,880	1,723
2010/11	3,311	1,488

Source: State Bank of Pakistan, *Annual Report* (Karachi: SBP, various issues).

Box 18.5

Paris Club Agreement 2001

On 13 December 2001, 18 participating creditor countries from the Paris Club approved Pakistan's third rescheduling deal since 1999 (referred to as 'PC-III' or Paris Club III). Under the agreement, in a major departure from the terms of previous rescheduling arrangements, the entire stock of pre-cut-of external public debt owed by Pakistan to this group of bilateral creditors—amounting to $12.5 billion out of a total outstanding of $13.5 billion owed to the Paris Club as of 30 November—was made eligible for restructuring. In the past, the country was provided breathing space only with regard to debt service falling due within a specified time frame (i.e. a flow treatment). Hence, for the first time, Pakistan received both a stock and a flow rescheduling.

In accordance with the terms of the agreement (outlined below in this box), it has been estimated that the reduction in the net present value (NPV) of Pakistan's debt stock owed to the Paris Club, in terms of estimated current account earnings for FY2002, amounts to a minimum of 30 per cent. However, the actual reduction is sensitive to the interest rate, which will be negotiated bilaterally. Given that the interest rates on the bilateral loans are likely to be lowered, the Government believes that the net reduction in the debt stock may be to the order of up to 45–50 per cent, in case of concessional treatment. If, however, the applicable rate of interest on these loans is not lowered significantly, at the minimum, the reduction in the NPV of the stock of eligible debt will be 30 per cent. This represents an important milestone in efforts to lower the debt burden.

The terms that have been applied to PC-III are as follows:

- Official Development Assistance (ODA) loans—totalling $8.8 billion—are to be repaid over 38 years with a 15-year grace period, at an interest rate at least as favourable as the original concessional rates applying to these loans;
- Non-ODA loans (comprising the balance) are to be repaid over 23 years, with 5 years grace and progressive payments at the appropriate market rate.

In addition, substantial cash-flow relief has also been provided by the Paris Club members during the period of the current International Monetary Fund (IMF) program with Pakistan (FY2002–04), as follows:

- maturing principal repayments of post cut-off date eligible debt as well as the moratorium interest falling due between 1 December 2001 and 30 June 2002 have been deferred for a period of five years, including three years grace;
- During the subsequent two years (FY2003–04), 20 per cent of interest accrued, including on the consolidated amounts, will be deferred.

All told, it is expected that the current agreement will generate an aggregate reduction in debt servicing over the FY2002–04 period of approximately $2.9 billion (net of moratorium interest). Over the course of the next 15 years, the Ministry of Finance, Government of Pakistan expects the total reduction in debt servicing payments at between $8 billion (base case) and $11 billion (if applicable interest rates are dropped by around 2 per cent).

Source: Sherani, Sakib, *Escaping the Debt Trap: An Assessment of Pakistan's External Debt Sustainability*, Asian Development Bank, Pakistan Resident Mission Working Paper Series No. 1, (Islamabad: ADB, December 2002), 30.

Salient Features of Paris Club Restructuring

Loan Group	Debt restructured	Consolidation Date(s)	Interest rate	Grace	Maturity	Repayment Profile
Paris Club eligible bilateral pre cut-off bilateral concessional loans	Reschedule stock	As of Nov. 2001	Original interest rate; interest rates on Japanese loans reduced to 2.4 per cent	15 years	38 years	Each payments Each semester
Paris club eligible bilateral pre cut-off bilateral non-concessional loans	Reschedule stock	As of Nov. 2001	Loan currency specific CIRR rate or equivalent proxy	5 years	23 years	Paris club provided repayment Profile
Paris club Concessional Pre. Restructure debt Jan. 1999 and Jan. 2001	Reschedule stock	As of Nov. 2001	Original interest rate; interest rates on Japanese loans reduced to 2.4 per cent	15 years	38 years	Each payments each semester
Paris club Non-Concessional PRD Jan. 1999 and Jan. 2001.	Reschedule stock	As of Nov. 2001	Loan currency specific CIRR rate of equivalent proxy	5 years	23 years	Paris club provided repayment Profile

Non-Paris club bilateral pre cut-off bilateral concessional and non-concessional	Reschedule stock	As of Nov. 2001	Original interest Rate	15 years	38 years	Each payments Each semester
Cash-flow relief maturities on post cut off dates	Defer 100 per cent Principal and interest	Dec. 2001 to June 2002	Market rate	3 years	5 years	4 equal payments each semester
Cash-flow relief interest payments due on restructure amounts	Capitalize 100 per cent interest	Dec. 2001 to June 2002	Market rate	3 years	5 years	4 equal payments each semester
	Capitalize 20 per cent interest	July 2002 to June 2003	Market rate	3 years	5 years	4 equal payments each semester
	Capitalize 20 per cent interest	July 2003 to June 2004	Market rate	3 years	5 years	4 equal payments each semester

Source: State Bank of Pakistan, *Annual Report 2001–02* (Karachi: SBP, 2002), 147.

near bankrupt Pakistan in 1998/99, much had changed—see also Box 18.6.

There were two or three factors which resulted in this unprecedented growth in foreign exchange reserves, showing an increase of a quite phenomenal 120 per cent within one year: between 2001/02 and 2002/03 State Bank of Pakistan reserves rose from \$4.33 billion to \$9.52 billion. One factor had been an increase in Pakistan's exports, crossing \$ 10 billion for the first time ever in 2002/03. With a rebound of the global economy and a greater access to European and US markets with quotas being increased, it was likely that this would happen and continue. A second important reason had been the State Bank's purchase of foreign currency from the kerb market. The State Bank became one of the most important buyers of foreign exchange, and bought substantial amounts in the years since 1999/2000. However, it has now ceased this practice and did not buy any foreign currency in 2002/03. Thirdly, with debt rescheduling, interest payments had also been reduced, allowing the State Bank to hold on to and increase, its reserves. It is important to point out that the more reliable and traditional forms of inflows, such as foreign direct investment, had absolutely no significance on increasing foreign exchange reserves, as they have in many other countries. Perhaps this is a matter of concern regarding the sustainability of the increase in foreign exchange reserves, especially if we consider the main cause for the substantial increase, particularly in those fiscal years.

Remittances have been a reliable source of foreign exchange earnings for Pakistan since the late 1970s. In the 1980s, particularly, remittances rose to very substantial levels equivalent to around 7 or 8 per cent of GDP in single years. However, since the early 1990s, and after the first Gulf War and due to structural shifts in labour demand in the Gulf States, the main area from where Pakistan received remittances, remittances fell substantially—see Table 18.1. Traditionally, the Gulf States have been the main sources of remittances into Pakistan. Saudi Arabia sent between 35–45 per cent of the remittances in the 1990s, the UAE about 17 per cent in 1999/2000 and Kuwait 15 per cent in 1999/2000; Britain provided about eight per cent of total remittances, and the US a maximum of 13 per cent in 1996/97, which had begun to fall thereafter, and was 8.75 per cent in 1999/2000. However, following 9/11 there was a dramatic change in both volume and composition of remittances.

In 2002/03, the Pakistanis in the US remitted US\$1.7237 billion, which was fifteen times the amount sent from the US in 1999/2000, just three years ago! This trend of substantially increased remittances from the US had begun in 2001/02, with \$778 million sent, which was ten times higher than the paltry \$79 million sent in 1999/2000. In 2002/03, the US with this substantially increased absolute amount of remittances, now provided as much as 29.53 per cent of remittances to the \$4.236 billion total, the highest amount ever received by Pakistan. Another significant development was that in 2002/03, Saudi Arabia's contribution had fallen markedly: from providing almost half Pakistan's total in the past, Saudi Arabia provided a mere 13 per cent.

The reasons for this unprecedented amount sent by Pakistanis from the US followed by Pakistanis in the UAE (20 per cent of total remittances in 2002/03), was a result purely of post-9/11 developments. The US government started scrutinizing accounts of Pakistanis and Muslims in the US, investigating funding for al-Qaeda type organizations. In order to avoid such investigations and in fear of their savings, many Pakistanis sent money to Pakistan which they would have preferred to keep in the US. The same sort of scrutiny had also begun in the UAE, and hence the increase in remittances from there. Moreover, the informal foreign exchange transfer mechanism, the *hundi*, which has been providing the main share of remittances to Pakistan from the Middle East,

Table 18.6
Overall Reserves as per BOP
(million US Dollars)

	FY00	FY01	FY02	FY03	per cent Share FY00	FY01	FY02	FY03
Opening balance	2,370	2,163	3,244	6,398				
Inflows	16,835	20,020	22,228	25,327	100.0	100.0	100.0	100.0
Exports of goods	8,190	8,933	9,140	10,889	48.6	44.6	41.1	43.0
Export of services (excluding interest)	1,396	1,367	1,929	2,801	8.3	6.8	8.7	11.1
of which: UK for logistic support	0	0	300	847	0.0	0.0	15.6	30.02
Workers' remittances	983	1,087	2,390	4,237	5.8	5.4	10.8	16.7'
Kerb market purchases	1,634	2,157	1,376	0	9.7	10.8	6.2	0.0
Foreign direct investment	473	286	366	585	2.8	1.4	1.6	2.3
Foreign portfolio investment	73	–140	–8	22	0.4	–0.7	0.0	0.1
Loan disbursements	1,588	2,740	2,910	2,392	9.4	13.7	13.1	9.4
Privatization proceeds	0	0	117	186	0.0	0.0	0.05	0.7
Official grants	940	842	1,500	1,014	5.6	4.2	6.7	4.0
Other receipts	1,558	2,748	2,508	3,201	9.3	13.7	11.3	12.6
Outflows	17,042	18,939	19,074	20,058	100.0	100.0	100.0	100.0
Imports of goods	9,602	10,202	9,434	11,425	56.3	53.9	49.5	57.0
Imports of services (excluding interest)	2,160	2,332	2,214	2,733	12.7	12.3	11.6	13.6
Interest payments	1,352	1,369	1,111	974	7.9	7.2	5.8	4.9
Amortization of official loans	1,174	1,202	967	1,228	6.9	6.3	5.1	6.1
Profit and dividends	233	301	457	631	1.4	1.6	2.4	3.1
Purchase of crude oil	187	312	394	473	1.1	1.6	2.1	2.4
Principal repaid on private loans	591	512	584	646	3.5	2.7	3.1	3.2
Foreign exchange liabilities liquidated	494	1,940	3,590	1,192	2.9	10.2	18.8	5.9
Swaps	0	866	441	235	0.0	44.6	12.3	19.7
Other payments	1,249	769	323	756	7.3	4.1	1.7	3.8
Net inflows	–207	1,081	3,154	5,269				
Gross reserves at end of period	2,163	3,244	6,398	11,667				
Sinking fund*	0	0	0	920				
Net foreign exchange reserves	2,163	3,244	6,398	10,747				

* SBP has also built up a sinking fund of US$920 million (SBP: US$730 million and commercial banks US$190 million) through the purchases of foreign currency lending from the interbank market for extinguishing central banks deposits placed with SBP or prepayments of other expensive loans.
Source: State Bank of Pakistan, *Annual Report 2002–2003* (Karachi: SBP, 2003), 185.

Box 18.6

Foreign Exchange Reserves Accumulation: 1999–2003

The profile of Pakistan's liquid foreign currency reserves has witnessed substantial changes over the past five years; not only has the *level* of the gross reserves risen substantially, from the paltry 930 million by end June 1998 to the US$11.7 billion by end June 2003, the *quality* of the reserves is also considerably improved.

During the 1990s, while private individuals were permitted to maintain foreign currency accounts with commercial banks, the latter were required to surrender the resulting forest proceeds to the SBP, adding to the country's forex reserves (as well as increasing the *claims* on these reserves). Until FY98, the strong net inflow into the private accounts was one of the most significant contributors to the country's forex reserves.

However, since Pakistan's external account remained in deficit, which in turn was financed by the SBP, the forex reserves available to the latter rarely reached above US$1 billion, despite substantial external borrowings. At the same time, the *claims* on the forex reserves, represented by the growing stock of private accounts, also rose to over US$11 billion by May 1998. In short, the entire stock of Pakistan's forex reserves, until FY98 was, in net flows, effectively through the creation of debt and liabilities.

This changed in the immediate aftermath of the May 1998 N-test, which precipitated a financial crisis and a freeze on withdrawals from existing private forex deposits. The consequent loss of confidence led to the sharply lower inflows through deposits (from US$1,476 million in FY98 to US$322 million in FY00) and a substantial reduction in remittances (from US$1490 million in FY98 to US$983 million in FY00), even as international sanctions constrained access to IFI credit. Thus, the stabilization of forex reserves during FY99 and FY00, essentially reflected demand management by the SBP in the formal market, as well as increased reliance on the informal market (e.g. kerb market purchases, that were not undertaken in prior years, totalled US$2165 million by FY00). Thus, the net increase in the country's forex reserves between FY98 and FY)) essentially reflects the impact of both, debt creating and non-debt creating flows.

The orderly management of the forex market by the SBP until FY01 and the uptrend in the foreign exchange reserves, despite the floatation of the rupee on the interbank market, helped restore market confidence and allowed the central bank to, once again, gradually liberalize the exchange rate regime. It was in this environment that the post-11 September accelerated remittances flows through the banking channels.

The sharp growth in workers' remittances through formal market during the last two years had led to an increase in its share of total inflows from a meagre 5.8 per cent in FY00 to 16.7 per cent in FY03. The increase in remittances is more a change of *route* than an *actual* increase as is evident from the changing shares of both the remittances and the kerb purchases in the overall inflows. The shares of the two when combined are almost unchanged since FY00, reinforcing the view that the workers remittances are in face now flowing through the interbank market rather than the kerb market.

In addition to the changes in workers remittances, the substantial improvement in goods trade-especially the exports, has led to a sizable decline in the net outflows on this account.

Another important source of the accretion in forex reserves since FY01 has been the resumption of large borrowings and grants. However, in contrast to the recent past: (1) the loans are on concessional terms, and (2) while significant, the share of these in total annual reserve accumulation is lower.

Finally, there are two noticeable changes in forex outflows during FY02 and FY03. First, the share of interest payments has been on the decline sharply, reflecting the effects of external debt management policies. Second, a significant portion of external liabilities has been terminated giving a permanent reprieve to a country.

In effect, post-11 September the forex reserves have risen largely on the back of non-debt creating flows, and the claims on these reserves have also declined sharply. In other words, the reserves have improved substantially in terms of both, quantity and quality.

Source: State Bank of Pakistan, *Annual Report 2002–2003* (Karachi: SBP, 2003), 184.

also came under scrutiny. To appear legal and to avoid complications with the authorities, many Pakistanis sent back money through the formal banking sector. Furthermore the State Bank of Pakistan and its commercial banks also took additional measures to capture the *hundi* market and since the differential between official and market exchange rates had been largely eliminated, were able to divert some funds away from the *hundi* market. Nevertheless, the main reason for this huge surge in remittances, were related to post 9/11 developments. (Pakistan was one of many countries where there has been a surge in foreign exchange reserves. See Appendix 18.1 for an interesting argument which explores this phenomenon with regard specifically to India, but raises some generic issues of concern, especially those related to a moral hazard.)

18.5 Did the Economy Turnaround?

With growth rates at their highest levels since 1995/96—5.1 per cent in 2002/03 and 7.5 per cent in 2003/04, the inflation rate down to its lowest in almost fifteen years, the fiscal deficit at its lowest in almost two decades, with remittances at their highest levels ever, with exports crossing the $10 billion mark for the first time and showing signs of further growth—the government started claiming that the economy had rebounded, that there had been a 'turnaround' and that the good times had returned. Even the stock market soared to inconceivable levels, setting new records every week. Pakistan was finally out of the ruinous decade of the 1990s and set on course for growth and development, such was the sentiment—see Box 18.7 as one example of numerous such

Box 18.7

Pakistan's Economy: A New Turning Point

Luck and good fortune have always played an important part in determining the economic fate of most countries. And Pakistan has had over the last fifty years its share of such fortuitous tidings.

The Korean boom in the early 1950s negated not only the adverse effects of Pakistan not devaluing its currency when Indian did in 1949, but the resulting rise in prices of raw materials generated the surpluses that financed Pakistan's initial industrial development. Large increases in foreign aid and loans bank rolled Pakistan's economic boom in the first half of the 1960s. The 'miracle' high yielding varieties of seeds of the 'green revolution' provided the much needed boost to a stagnant agricultural sector and the resulting increase in food gain production was able to fed and sustain a population growth of over 3 per cent-amongst the highest in the world. The large inflows of remittances from migrants to the middle-East in the latter half of the 1970s and through the 1980s provided the much needed foreign exchange to pay for the three-fold increase in oil prices following the 1973 Gulf war and were perhaps the single most important factor in reducing poverty levels in the 1980s.

Then came the 1990s and it appeared that 'lady luck' had deserted us. Remittances fell. Out migration drastically slowed down. Agriculture production was hit by pest attacks on cotton our major export earner. Drought and water shortages further ground the economy. The country faced a mounting foreign and domestic debt. Poor economic management as political considerations dictated unsound economic decisions made matters worse. Under these poor and deteriorating economic conditions Pakistan entered into an IMF/World bank supported structural adjustment program which left the country reeling with poverty levels doubling to over 30 per cent (for the first time higher than in India) and the economy grew in the 1990s at half the 'Pakistani growth rate' of over 6 per cent of the earlier decades.

Then the unexpected happened. Foreign remittances which had been around $1 billion over the past many years showed an upsurge in the past two years and dramatically increased to $4.3 billion in 2002–03, the result of tightening controls on illegal transfers and scrutiny of foreign accounts in most countries. Even if we assume that another $1 billion was earlier entering the economy through un-official channels (as earlier studies had indicated that around 57% of remittances came through official channels), the net increase in remittances injected about $2.5 billion into the Pakistan economy. This amount is almost equal to the current annual development plan (ADP) of around Rs. 160 billion and around 3.5 per cent of Pakistan's gross national product (GNP) of around $70 billion.

But this was not the only favourable change in Pakistan's economic fortune. Rescheduling and retiring of foreign debts (estimated present value of around $10 billion), increase in export quotas mainly to the European Union and better weather conditions have placed us in an economic position which few would have thought we would be a few years ago. Credit here must also be given to prudent economic management (which some may term as 'over cautious') which certainly facilitated the turn around. But few would dispute that the critical factor has been 'old lady luck' which had deserted us during most of the 1990s.

The real test of Pakistan's economic managers will come now. As long as a country works under an IMF/World bank adjustment program there is little room to manoeuvre. You mostly follow that you are told to do whether it is fiscal or monetary management of the economy. Now that there is an opening in terms of both 'fiscal space' and a foreign reserve 'cushion'. How we use this to ignite growth and reduce poverty will be the yardstick on which the performance of our economic managers will be judged.

Good economic management requires a feel, and good understanding, of the intricate dynamics of how the Pakistan economy functions and what makes it tick. It also requires drawing the right lessons from our recent economic record. The situation which led to the freezing of foreign currency accounts and for which most Pakistanis abroad have still not forgiven the government must never be recreated. The 'dollarization' of the economy, which a premature open convertibility of the rupee and foreign capital transfers did immeasurable damage to the economy, not least in facilitating flight of capital. Finally allowing economic decisions making to be dictated by purely political expediency forced us into an economic situation and corrective adjustment program which will take many years to fully recover from.

The people of Pakistan have suffered with great fortitude and patience the ill effects of a severe structural adjustment program, especially in the form of higher utility prices and rising unemployment. The new economic scenario now provides an opportunity to 'reward' them for their patience. Let me offer some suggestions:

- use the stability of the foreign exchange rate as the fulcrum on which the recovery should rest. A stable foreign exchange rate generates investors confidence both domestic and foreign and helps ward off inflationary pressures.
- do not be in a great hurry to 'sterilize' the increase in foreign exchange inflows including through retiring foreign debts.

Let the flows work themselves through the economy-even if the first round effects are directed at increasing prices of real estate and stocks-the second and subsequent round effects will stimulate growth in the 'real' economy and stimulated new investment to meet demand.

- Do not be overzealous in either 'privatization' of public assets or in 'policing' the private and public sector. As regards the former, clearly weight costs and benefits and always remember the only real security a worker has in this country is his job. As regards the latter it is important to remember that no 'economic boom' has blossomed in an atmosphere of fear.

Source: Rashid Amjad, in *The Nation*, Lahore, 6 October 2003.

Box 18.8

Policy Options: Helping or Hurting the Poor?

Reduction of the budget deficit, current account deficit, savings deficit, or the rate of inflation are all laudable macroeconomic stabilization objectives. However, the way in which these targets are achieved has different distributional implications. There exists a range of policy options to achieve given ends, some of which are pro-poor and others which are not.

For example, raising revenues or reducing expenditures can lower the budget deficit. Revenues can be raised through direct taxation or through indirect taxation: the former impacts the rich, while the latter largely impacts the poor. Expenditure reduction can be attained through cuts in current expenditure or through cuts in development expenditure. The former impacts on existing employment, while the latter impacts on employment generation. However, while development expenditure is likely to crate assets and a future stream of income, current expenditure is likely to be consumptive. Generally, labour productivity in employment, generated through development expenditure, is likely to be higher in employment generated through current expenditure. Thus, while employment on account of development expenditure may be productive. As such, switching expenditure from current to development heads may increase employment and incomes, and reduce poverty in the future.

The current account deficit can be lowered through changes in both the trade and non-trade related categories. With respect to trade categories, the current account deficit may be reduced on account of higher export receipts or lower import payments. The changes may be the result of an increase in the value or volume of exports or a decrease in the value or volume of imports.

Higher export receipts on account of higher value of exports are likely to accrue more foreign exchange for the same level of output, as well as enhancing incomes for exporters and generating growth. Higher export volume is likely to generate more output and employment, leading to higher income. Lower import volumes, at Pakistan's current level of development, are likely to be reflective of recessionary tendencies, i.e. a slowdown in economic activity, and impact adversely on employment, income and growth.

With respect to non-trade categories, the current account deficit may be reduced through lower debt servicing on account of debt retirement or write-offs or rescheduling. Lower debt servicing on account of debts retirement or write-offs releases resources for investment or consumption without future liabilities, while debt rescheduling transfers liabilities to future generation. This liability can be neutralized if the resources released are employed for the creation of income generating assets.

The savings deficit can be lowered through an increase in savings or decrease in investment. The increase in savings can be employed to finance investment, which is likely to generate employment and income. To the extent that the increased output is exported, there is a positive impact on the current account. A decrease in investment reduces output, employment and income. The contraction in output may also impact adversely on exports and on overall growth.

Inflation can be lowered through controlling cost-push or demand-pull factors. The former involves intervening on the supply side and reducing the cost of production, which tends to enhance product competitiveness The latter involves intervening on the demand side by curtailing both purchasing power and consumption. Where consumption levels are already below subsistence standards, further reductions can have adverse effects on nutrition and health, as well as on social stability.

Two instances can be cited as to whether a policy response in pro-poor or otherwise. The Pakistan economy faced a major challenge in the aftermath of the nuclear tests and the ensuing sanctions. A series of policy responses were contemplated. Policymakers proved to be sensitive to the impacts on the poor and, while the poor were a target, the negative effects were minimized. For example, in response to the slide of the rupee in the foreign exchange market, a dual or multiple exchange rate regime was adopted during the peak period of the crisis. The move was not sanctioned by the IMF, but was risked nevertheless to protect consumer prices of essential imports like petroleum oil and lubricants (POL), pharmaceutical products, edible oils, pulses, etc. In contrast present day policymakers have tended to bow to international creditor pressure and have followed an implicit policy of exchange rate depreciation without sufficient consideration of the impact on essential commodity prices or accompanying measures to protect the poor. An indicator of such insensitivity is the slapping on of a sales tax on medicines.

Source: Social Policy and Development Centre, *Growth, Inequality and Poverty: Annual Review 2001* (Karachi: SPDC, 2002), 30.

articles appearing daily in the Pakistani press, and Box 18.8 for a somewhat different perspective.

There was no disagreement over the claim that the economy had done far better since 2000/01, than it had for many years. In fact, one could predict that it was very probable, that this trend would continue into the next two or three years as well. The growth rate was likely to be above 5 per cent for the next few years, exports would probably not fall below the $10 billion mark, and with the substantial fiscal space created on account of the Paris Club rescheduling, it also meant that the pressure on the economy, at least for a few years, had been eased. There was also no denying the fact that this change had taken place on account of the developments, globally and particularly, in the region, on account of 9/11. What was questionable, however, was the claim that Pakistan was out of the woods, headed for sustained development and growth.

The reasons for this scepticism rested on a number of factors. One reason was that the recovery that had taken

place in Pakistan, had taken place on the back of high remittances, which were likely to subside to much lower levels than those seen in the fiscal year 2002/03. This meant that additional foreign exchange reserves were likely to have lower rates of increase, since remittances were a key factor causing the increase. A second reason was that, once the WTO regime took effect, with a quota-free textile world, Pakistan would faced greater competition and would not be allowed the privileged access granted after 9/11 to the US and to Europe. This may result in the growth rate of exports slowing down and resulting in a possible deterioration of the much improved current account balance. Besides, with 65 per cent of exports being textile-based, a more serious crisis may have been overlooked by the increase in exports in 2002/03.

Poverty in Pakistan continued to be a major concern, with almost a third of the population below the poverty line. Unless GDP growth stayed above the 5.5 per cent level for a number of years, it was improbable that Pakistan would see any decrease in poverty levels. One of the main problems facing Pakistan was that of job creation and poverty alleviation based on active private sector investment. This was particularly important because the public sector has been withdrawing from productive activities and had been cutting down, as well as privatizing, its assets. The government still insisted on further reducing the fiscal deficit to below 4 per cent of GDP, restricting resources for development. Moreover, 'in real terms, overall private fixed investment has remained virtually stagnant for much of the 1990s, while fixed investment in large-scale manufacturing has exhibited a secular declining trend during the period'.[21] Sherani continued, 'the failure to elicit an investment response from the private sector despite a significant degree of structural adjustment undertaken has been the weakest links in Pakistan's efforts to forge sustainable economic development. As would be obvious, the low level of investment represents a key constraining factor for the long-term prospects of the economy'.[22] Table 18.1 shows that investment between 2001–03 was only 13 per cent of GDP, far lower than earlier trends, and probably the lowest since the late 1950s.

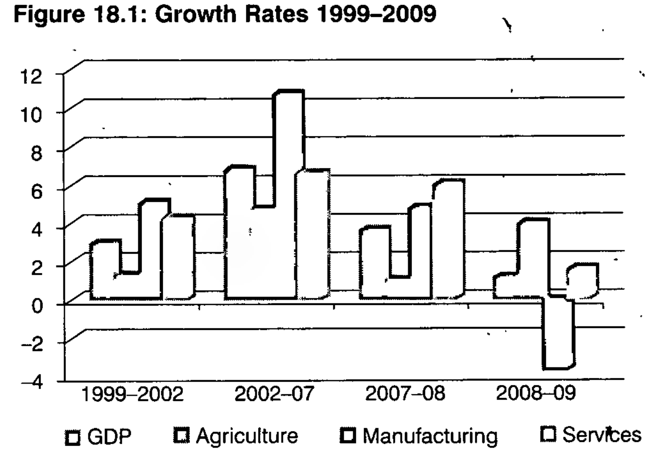
There was a debate between those who felt that Pakistan's economy was showing signs of a turnaround, and those who cautioned against such optimism, since most of the fundamentals were still weak. Critics argued that the boom or turnaround was based on false foundations, and a bubble had been created which was eventually going to burst. Subsequent developments showed how artificial and temporary the so called turnaround actually was.

18.6 Musharraf and After: 2004–2008

Many of the issues raised in 2005 in the Second Edition of *Issues*, partially reproduced in Section 18.5, questioning the so called 'turnaround', became more real towards the end of the Musharraf government's tenure, and later when Musharraf's Caretaker government (November 2007 to March 2008) took over. Since Musharraf was still President of Pakistan, although he gave up his uniform and became a civilian president, the Caretaker government under Musharraf, took numerous poor decisions where politics trumped economics, in an attempt to get Musharraf's King's Party, the Pakistan Muslim League Quaid-i-Azam, re-elected in a power sharing agreement with Benazir Bhutto's Pakistan People's Party. Numerous deals were struck between both leaders to ensure a smooth transition of so called 'liberal' forces, and the documents and evidence from that time have revealed how individuals from the UK government and from the United States, were involved to ensure such a coalition government—see Chapters 26 and 27 for the politics of the time and what such arrangements meant for the post Musharraf and post military transition. In this Section, we look at how economic decisions were affected by political developments.[23]

In this chapter we have shown there is little disagreement over the fact that the Pakistan's economy showed some remarkable positive trends in the key indicators during the 2002–07 period when General Pervez Musharraf was in power—see Figure 18.1. The single most important attribute of Pakistan's economy throughout the 1990s was its excessive and severe debt burden. In 2001/02, external debt was equivalent to 57 per cent of GDP, and domestic debt accounted for 43 per cent. Hence, the overall outstanding debt was about the size of the GDP, with foreign debt servicing alone, in 2001/02, equivalent to as much as 10 per cent of GDP. Pakistan was paying a huge share of its foreign exchange income each year as debt owed to foreign institutions and countries, leaving little for domestic development. By 2006/07, domestic debt had fallen to 30 per cent of GDP, and foreign debt servicing was less than 5 per cent of GDP. On account of agreements reached with bilateral and multilateral donors following 9/11, huge amounts of debt were either written off or rescheduled, allowing the Musharraf regime unprecedented fiscal space to play with every year. It was the access to these funds and the fact that debt servicing had slowed down remarkably, allowing foreign exchange earnings to accumulate, and that large amounts of multilateral and bilateral aid was made available, which was the key reason why the economy turned around so sharply.

Figure 18.1: Growth Rates 1999–2009



These factors allowed the growth rate to rise to 9 per cent in 2004/05, the highest in two decades, which followed a growth rate of 7.5 per cent in the previous year; the fiscal deficit was

near its lowest in almost two decades, remittances were at their highest levels ever, exports crossed the $17 billion mark for the first time. The government claimed that the economy had rebounded, that there had been a 'turnaround' and that good times of high growth and high human development had returned.

Following the 2002–07 period, it was believed by many, that Pakistan was finally out of the ruinous decade similar to the 1990s and was set on course for growth and development on its way to achieving extraordinary, and sustained, economic prosperity. Despite exceptional and unanimous support from the international diplomatic and donor community, with little political opposition at home, and with uninterrupted stability and control of government unlike the eleven changes of government between 1985–99, these few years of remarkable growth, quickly unravelled.

The boom of the Musharraf years was built upon false foundations, largely consumer-led growth and investments in the speculative—real estate and stock market—sectors, with remittances and foreign aid driving this growth. What was missing was a long-term strategy and direction needed to guide this money being sent to Pakistan into more productive sectors. Banks, awash with excess liquidity, were eager to lend cheap money for consumption to the growing middle class, without perhaps taking cognizance of future repayment prospects. This consumer-led boom did signal activity in the manufacturing sector with demand for cars, motorcycles, and other items increasing, yet the large inflows helped create a bubble, which eventually burst.

The fiscal space that was created allowed the government to provide the much needed infrastructure, and indeed roads were built and communication networks advanced, but these developments were unable to keep pace with the increase in demand. The success of the consumer boom may have caught the government unawares in providing resources needed for the demands of the middle classes with their consumption needs. The best example of this is the huge demand in power consumption which emerged as a consequence in the high spurts of economic growth, which the government was unable to meet, resulting in extensive shortages of electricity affecting domestic manufacturing and industry. Persistent inflationary pressures and weak performance of key sectors of the economy and emerging bottlenecks in infrastructure particularly in the power sector, the surge in global commodity prices, especially in oil prices, led not only to an unprecedented rise in inflationary pressure but also made the balance of payments position very vulnerable. The downside impact of the boom years has been the evidence of growing income inequality among the different income groups.

Pakistan's average real GDP growth rate during 2004–07 at over 7 per cent per annum, stimulated by monetary and fiscal policies, was amongst the best recorded in recent decades. This welcome improvement in macroeconomic performance was the result of a confluence of fortuitous circumstances including a strong influx of external capital flows, both private and public and a benign international economic environment, along with favourable weather conditions contributing to high growth in agriculture. Much of the growth during this period was, however, stimulated by domestic demand while exports growth remained lacklustre and although the growth of exports rose by 10.2 per cent, the current account deficit 2006/07 rose to 5 per cent of GDP compared to 4.4 per cent in the previous year. The strong inflows in capital account more than offset the current account deficit and added to the stock of foreign exchange reserves which reached $16.7 billion at the end of the year. The total foreign investment reached an all time high in the country's history and amounted to US$8.42 billion as against US$4.48 billion in 2005/06 and US$1.67 billion in 2004/05. Foreign direct investment (FDI)—an important component of foreign investment—amounted to US$5.1 billion in 2006/07. This strong surge in foreign investment was concentrated in four major sectors, i.e. telecommunication, energy, banking and finance and food and beverages, and accounted for 80 per cent of the FDI inflows. The origin of FDI inflows was also concentrated among five major sources, namely, UAE, USA, UK, China, and Netherlands. This strong performance of the economy became unsustainable beyond 2006/07, because of the confluence of numerous political factors—see Chapter 27—and the economic factors discussed below.

The drying up of capital inflows and the withdrawal of portfolio investment from the stock market, as a result of political uncertainties and the deteriorating security situation, after the intensification of the War on Terror, further exacerbated the economic decline. As a result, rising fiscal and current account imbalances necessitated a domestic stabilization programme with the help of an IMF Standby Agreement (SBA). The SBA of $7.5 billion was approved for one year by the Executive Board of the IMF on 24 November 2008, and was augmented to $11.3 billion and extended through to end-2010—see Section 18.7. However, the SBA loan while helping the short run stabilization of the economy increased the external debt stock and limited the room for fiscal expansion, as had happened in the period after 2002.

The inability, or reluctance, to deal with the speculative bubble that was emerging in the economy around 2007, along with political activity and the subsequent rise in oil and fuel prices, was a key factor which brought the economy to a halt in 2008, with the growth rate of a mere 1.2 per cent per annum. Furthermore, the IMF stabilization package resulted in considerable belt tightening and stabilization at the cost of growth and employment. The fiscal crisis of the state returned with debt increasing, and the fiscal space of the 2002–07 period was squeezed with the Public Sector Development Programme being cut considerably.

While many of the core economic indicators of the Musharraf period between 2002–07 did remarkably well, perhaps the greatest disappointment with the Musharraf government, at least regarding the economy, was that it did not do enough and was caught up in a PR—Public Relations—'image' game, citing numbers from the economy showing growing consumption and speculative investment. Another reason for the failure of the Musharraf government was the windfall which accrued on account of debt rescheduling—thus creating a huge fiscal space—*was that not enough was made of these fortuitous circumstances*, and all these short-term gains were squandered away in conspicuous consumption.

It was a rare opportunity for any government to have access to such possibilities and such riches, but the Musharraf-Shaukat Aziz government lost the opportunity to transform these possibilities to put Pakistan on a long-term, high-growth, development path.

Musharraf's Caretaker government is remembered more for what it did not do, than for what it did, even in the few weeks it was in office. The growth rate in 2007/08 was at 3.7 per cent, less than half just a year earlier, and while there were numerous factors which resulted in this fall, the role of the Caretaker government was critical. For political reasons, 2007 had been a particularly tense year. Events such as the sacking of the Chief Justice of Pakistan by General Musharraf, led to the lawyers' movement. In the summer of 2007, the Pakistan army stormed the Lal Masjid in Islamabad killing scores, if not hundreds of students and teachers, as well as militants. As a consequence of the Lal Masjid attack and also because of the continuing War on Terror, the security situation in Pakistan began to deteriorate from 2007 onwards. There was also a political and popular movement against Musharraf, which led him to impose an Emergency in November 2007, almost as severe as a Martial Law, where draconian measures curtailed voices of protest against an increasingly unpopular General-President. These political factors coincided with the end of the tenure of the 2002 Parliament, which required elections to be held and a Caretaker government put in place to oversee elections. However, in addition to all these factors, was the start of a growing international economic crisis, some aspects of which had emerged prior to 2007.

Prices of international commodities, particularly oil and essential food crops, had begun to increase, with the price of oil alone, increasing from $93 a barrel in the middle of November when the Caretaker government took office, to $110 by the middle of March when the new incoming government took over. Earlier, in mid-2007, the price of oil was around $60 a barrel. The international price of oil almost doubled at a time when Pakistan was facing many political disruptions and transitions in the critical nine-month period. With Musharraf becoming increasingly unpopular and an election around the corner, his governments were interested in creating favourable conditions which would have allowed his PML-Q to gain a majority in the elections to be able to form a government with Benazir Bhutto's People's Party. This would have meant that the price of oil domestically, would not have been allowed to increase in line with international prices, a popular move, but with serious negative consequences for the economy overall. While the international price of oil doubled between January 2007 and March 2008, it increased by only 9 per cent for the Pakistani consumer. While both the Musharraf governments were responsible for subsidizing this increase, it was the Caretaker government which faced sharper price rises and chose to put political expediency first.

The same sort of inaction was noticed with regard to the rupee/dollar rate. Pakistan's rupee was almost tied to the US dollar, though not officially as such, but needed to be devalued. Given the rise in oil imports and a deteriorating balance of payments situation, the Caretaker government decided not to devalue the rupee/dollar parity. In addition, international food prices had been rising along with the price of oil, and this was causing inflationary pressure on Pakistan. The Caretaker government did not want to take any unpopular measures which would have improved the economy in the longer term, but would have cost them the election and the vote. The *Pakistan Economic Survey* in 2008, summarized many of the issues which had been avoided earlier and were to later trouble the new government for some years to come:

> Failure to pass on the increases in the international prices of oil and food to domestic consumers severely affected current expenditures as the government continued to finance these increases through the budget, with subsidies rising to an unsustainable level. A subsidized power tariff also added to the slippages. The extra-ordinary increase in development spending was not consistent with a stable macroeconomic framework. The increase in fiscal deficit coincided with a sharp decline in the external financing flows. Consequently, the government was forced to rely on SBP for budgetary financing. Government borrowing from the SBP has reached an all time high, leading to excessive monetary expansion and thus becoming one of the principal sources of inflationary build up in the country. In other words, financial indiscipline during the year, mainly on account of political expediency, has already caused severe macroeconomic imbalances, for which, Pakistan is likely to pay a heavy price in terms of deceleration in growth and investment, and the associated rise in poverty; the widening of current account deficit and the attendant rise in public and external debt; a loss of foreign exchange reserves and the associated pressure on the exchange rate, and most importantly, higher inflation and the accompanying rise in interest rates. There is no better way to explain the central importance of fiscal discipline in promoting growth and investment. Fiscal year 2007–08 has reminded us clearly that even one year of fiscal indiscipline is enough to damage several years of efforts to restore macroeconomic stability.[24]

The nonpartisan Institute of Public Policy (IPP) in Lahore, shared the same sentiment:

> As outlined in some detail in IPP's last year's report, the worsening of economic balances had already started in 2006 but gathered great momentum during 2007 and 2008. Oil prices continued to rise steeply, and international commodity price inflation spread to grains and edible oils. Indeed, 2007–08 was the worst year from the point of view of negative external shocks, precisely when Pakistan's political situation was unravelling and initially at least was thrown into total turmoil with the assassination of Mohtarma Benazir Bhutto, the head of PPP, at the end of 2007. Needed economic adjustments especially in energy prices were not

> made. The fiscal and monetary policies remained expansionary as Pervez Musharraf-Shaukat Aziz government remained preoccupied with pushing short-term growth through large public spending in preparation of elections. Meanwhile, the neglect of emerging structural problems in three key sectors—energy, agriculture and exports—began to hamper productivity, competition, and growth. The lack of energy investment and large scale power shortages have seriously hurt the economy, export growth has slowed and the long term agriculture growth rate appears to have declined from 4 per cent to 2.5–3.0 per cent per annum.
>
> In the last few months of Prime Minister Shaukat Aziz's tenure, the growing economic concerns were totally pushed aside as attention focused entirely on the political future of President Musharraf. Unfortunately the technocratic caretaker government that came into office in late 2007, unlike some previous caretaker governments, also took little decisive action to stabilize the economic situation. An important opportunity was thus missed to start the economic adjustment process even though fiscal and balance of payments deficits had widened, the energy subsidy bill was growing and the inexorable rise in the international oil prices was continuing.[25]

We now know that Musharraf's strategy to create favourable conditions to win re-election failed, and the analysis of the Musharraf government's economic policy also tells us, that it was a short-term growth strategy resting on weak foundations. As we argue above, '*the biggest failure of the Musharraf regime's economic policies was the inability to use fortuitous circumstances to launch a long-term economic growth trajectory and to transform Pakistan's economy.* All those who consider the Musharraf years as successful in economic terms, need to examine the huge potentialities which were missed despite the many opportunities which existed. Also, for the most part, it was 9/11 which caused the short term boom in Pakistan, not General Musharraf and Shaukat Aziz's economic strategies or policies—see also Chapter 25 and Appendix 18.3.

18.7 The Pakistan People's Party's Economic Policies 2008–2013: Bad Luck or Bad Management?

As we have argued, when the Pakistan People's Party (PPP) government came to power in 2008, it came in at a time when numerous serious crises—both political and economic—were already signalling difficult times ahead, and there were many indications of things getting far worse. As if oil prices were not already high enough, just four months after coming into power, with the advent of democracy following nine years of military rule—itself a difficult transition, as we have seen in 1970 and 1988—oil prices rose to $145.29 a barrel in July 2008, the highest ever. There were also increased food prices causing high inflation, and in the 60 months of power of the PPP government, prices in Pakistan were in double digit for almost fifty months! For many of the critics of the Pakistan People's Party, the performance of the economic teams since 2008, has been the worst in Pakistan's history—see Box 18.9. However, is this a fair assessment?

The dominant narrative of most economists, at times also of the PPP government itself, from 2008 onwards, was that the economy was in a state of grave crisis. Any number of economists and other analysts writing in newspapers consistently churned out articles stating that the economy was at its worst ever since Pakistan was created, that it was on the brink of collapse, meltdown, and many more colourful clichés which repeated the same theme. Even highly respected think tanks, which have produced some of the best analysis on Pakistan's economy, persisted with this theme. The Institute of Public Policy of the Beaconhouse National University, Lahore, in each of its five Annual Reports since 2008, reiterated this argument. In its 2008 Annual Report, Pakistan's economy was seen at a 'critical juncture';[26] the 2009 Annual Report stated that 'Pakistan is currently faced with a crisis that in terms of its scope, reach and likely consequences has no precedent ever in our exceptionally turbulent history cannot be disputed',[27] and the Report highlighted the crises on many fronts. The 2010 Annual Report was entitled 'Pulling Back from the Abyss', signifying concern about where the economy was heading, highlighting numerous concerns and asking whether Pakistan was 'on the edge of the abyss';[28] the Fourth Annual Report of 2010, was released at a time of 'gloom and turmoil', with the economy on the 'knife edge';[29] and the Fifth Annual Report continued with the theme that 'Pakistan's economy remains precarious'.[30] Were all these economists correct in their assessment of the economy? See Boxes 18.10 and 18.11 for views which question the crisis narrative.

No matter what the eventual economic performance of the PPP government, and whether they were responsible for or unable to deal with, the economic crises which some economists felt had occurred, one cannot underestimate the nature of the issues which the PPP government inherited. As we show in Section 18.6, the reluctance by both the Musharraf governments, especially in 2007 and early 2008, to undertake essential decisions to address problems in the economy, resulted in things deteriorating further. Oil price rises and soaring food prices caused severe inflation in Pakistan just as the PPP government was settling in, a factor which was to afflict it for almost all its five years. The costs and nature of political transition from a military government which had denied democracy for nine years, made matters far worse. Add to that the huge law and order situation and the deteriorating security condition on account of the War on Terror, one has a situation which would have challenged the best of administrations and governments. The Institute of Public Policy Annual Report of 2009 is quite correct in stating that 'by the time the new democratically elected government took office in March 2008, the macroeconomic situation was becoming quite desperate'.[31] This was also Pakistan's first major coalition government, with both the Pakistan People's Party and Nawaz Sharif's Pakistan Muslim League

Box 18.9

Evaluating the Performance of the PPP's Economic Management

Ashfaque H. Khan and Zubair Mohammad examine the economic performance of the PPP government.

I.

The finance minister faced serious criticism of his performance by his cabinet colleagues in the federal cabinet meeting of October 31. Minister after minister, including the prime minister, criticised the finance minister for mishandling the economy, in particular the price situation. The finance minister responded to the criticism in equally terse language. Such an episode in the cabinet is not uncommon. When the chips are down, blame-game is a common phenomenon in our society.

In responding to the criticism the finance minister at least revealed the truth. He came down hard on the political leadership for the new NFC Award and launching of the Benazir Income Support Programme (BISP). From his point of view, the NFC Award and the BISP are responsible for the persistence of higher inflation in the country.

Is the finance minister solely responsible for severely damaging the economy? While the minister is to be blamed for presiding over the economic destruction as captain of the economic team, the political leadership cannot absolve themselves from the destruction of the economy either. The political leadership is to be blamed for not focusing on the economy since they took charge of the country's affair. They brought frequent changes in the economic team and hence did not allow the appointees to work with confidence. The members of the team they appointed were weak, disjointed, with little understanding of the ground realities. The political leadership did not provide adequate support to its economic team in undertaking difficult structural reforms, particularly in the areas of taxation, expenditure, power sector subsidy and social safety net programmes. They themselves failed to maintain fiscal discipline, forcing the economic team to borrow recklessly to finance their unmet desire and needs.

It was the decision of the political leadership to criminally increase the support price of wheat without caring about food prices and the poor of this country. It was also the decision of the political leadership to finalise the NFC Award without any economic foundation. This award has destroyed fiscal discipline and sowed the seeds of perpetual macroeconomic crisis in the country. Pumping taxpayers' money in rotten public service enterprises (PSEs) to keep them afloat, providing Rs. 1.5 trillion to the power sector to finance their corrupt practices and inefficiencies and borrowing in dollar terms, converting them into rupee, and dropping them on 3.5 million households were also the decisions of the political leadership.

On their part, the weak and disjointed economic team simply failed to comprehend the economic challenges facing the country. The laidback, lethargic and non-serious attitude of the team further compounded the difficulties. The captain of the team never bothered to include honest, efficient and dedicated civil servants, nor professional economists fully aware of the ground realities in the team.

The economic team kept the private sector at bay and never communicated with the people of Pakistan. The team, particularly the captain, failed to muster the courage to prevent the political leadership from taking fiscally irresponsible decisions, such as raising the salaries of government servants by 50 per cent in one go at a financially distressed time, increasing the support price of wheat by more than 100 per cent, frequently bailing out rotten PSEs, doling out trillions of rupees as power-sector subsidy, spending money allocated for the year in just three months, adding project after project in the list of the development programme by bypassing the parliamentary approval, and so on.

The economic team lacked the courage to call a spade a spade. For example, the captain of the team acknowledges privately that the new NFC Award was a disaster for the economy but lacked the courage to tell this to the political leadership. Only when he came under attack in the cabinet did he do so. The team never warned the political leadership about the ill-effect of the BISP and the power-sector subsidy.

A fiscally irresponsible government, together with a weak, disjointed and non-serious economic team have damaged the economy to the core within five years. There is general consensus at home and abroad that Pakistan's economy was never in such dire straits since its inception.

After almost five years at the helm of affairs, the score card of the government and its economic team is certainly dismal at best. Economic growth has slowed down to an average of three per cent per annum, investment is down to a 60-year low, domestic savings have never been so low in the history of this country, unemployment and poverty have risen, the budget deficit has reached an all-time high (8.5 per cent of the GDP) last year and expected to attain a new height this year, and public debt has more than doubled in the last five years.

An external debt repayment crisis is knocking at the door, the exchange rate appears to be in freefall, foreign exchange reserves are depleting fast, foreign investment has vanished, domestic investors are moving abroad and creating jobs in other countries. Electricity and gas "shortages" have affected the lives of millions of Pakistani and hurt economic activity in the country; the law and order situation has deteriorated and badly affected the country's economy, inflation persisted at double-digits for 55 months in a row, PSEs are bleeding profusely, state institutions have collapsed and the writ of the government has vanished.

With economic destruction all around, the government and its economic team are least bothered. The media, civil society and parliament appear to have lost interest. Those at the helm of affairs are bent upon emptying the national exchequer by March 2013. Those who can really make a difference in salvaging the economy have become silent spectators. Let the haemorrhaging of the economy continue. Let politics override economics. Let the people of Pakistan continue to suffer.

Source: Khan, Ashfaque Hasan, and Zubair Mohammad 'Blame Game', *The News*, Karachi, 6 November 2012.

II.

In my last column, I briefly mentioned the dismal economic performance of the present PPP government. After the article was published, many of my PPP friends called and challenged the basis of describing the economic performance dismal. Under what rationale they questioned the bad performance is not clear to me. The PPP's performance has not just been bad but dismally bad and I would call it the worst economic performance by any government since our independence. The following macro-economic indicators will demonstrate my point.

GDP growth: Average GDP growth during 2008–12 has been 2.9 per cent. Never in our history has the growth for any four-year period been so low. Let us compare Pakistan's GDP growth with other countries in the region during the same period, which were as follows: India 7.8 per cent, Bangladesh 6.8 per cent, Sri Lanka 6.1 per cent and Pakistan 2.9 per cent. Most economists would agree that in order to progress and for people to survive above the poverty line in Pakistan, nothing less than a six per cent sustainable growth rate is required.

Inflation: Except for the last two to three months, inflation has remained in double digits during the entire period of this government. Looking at this from a historical perspective, this has been the second worst period since 1947, as far as inflation numbers go. Only once in our history we had a higher inflation over a four-year period and that was during the first PPP government in 1972–77. Compared with us, India had single-digit inflation throughout much of the same period. Pakistan's economic managers cannot complain of high oil and other commodity prices for its high inflation numbers.

Tax-to-GDP ratio: When the PPP came in power in 2008, the tax-to-GDP ratio was 10 per cent and the plan was to increase it by one per cent each year so that by 2013 it would be a healthy 15 per cent. At present, the ratio is less than nine per cent, which would rank Pakistan among the worst in the world. This helps explain why the present government has been unable to deliver in terms of investment in social sectors and infrastructure projects. There is no rocket science here—you either increase the revenue side or reduce the non-development expenditure or ideally a combination of both.

Budget deficit: Last fiscal year, the budget deficit was at an all-time high of approximately seven per cent but even more alarming is the forecast for the present fiscal year, which is expected to see a budget deficit in the range of eight to nine per cent. What does that mean for the economy? In terms of actual rupees, it means a deficit of more than two trillion, which will largely be filled in through borrowing from the central and commercial banks. It has adverse effects too. This will crowd out the private sector simply because the commercial banks would not have much to offer to the private sector and in any case, it is much easier to lend to the government without taking any risk.

Investment-to-GDP ratio: In 2008, this was 23 per cent, which has now come down to 12.5 per cent—the worst for more than 30 years. A 10 per cent drop in this ratio simply means approximately 20 billion dollars in terms of lost investment.

The numbers speak for themselves. All other indicators are also negative. Public debt has more than doubled in the last four years. State institutions such as Pepco, PIA, the Railways and the Pakistan Steel are all making huge losses (around Rs. 400 billion every year). Pakistan is facing the worst energy crisis in its history and no improvement is evident. The privatization process is almost at a standstill.

The economic situation is grim, to say the least and there is a general perception that the situation is unlikely to improve, since no structural reforms are planned and in any case, it is too late to initiate any such reforms.

With such a miserable economic performance, any chance of the PPP being returned to power in the next election looks almost impossible.

Source: Mohammad, Zubair, 'The PPP's Terrible Economic Performance', *Express Tribune*, Karachi, 7 November 2012.

joining together, with General Musharraf, now retired, still as President of Pakistan.

These conditions were bad enough, with the current account deficit 8.7 per cent of GDP in 2007/08 and the fiscal deficit 7.6 per cent, but added to this in 2008, was the global economic crisis followed by the international recession which continued well into 2013. Faced with these rather severe challenges, the new government had to take unpopular decisions. As the Institute of Public Policy Annual Report argued,

> Undoubtedly the new government inherited a most difficult economic situation. It started the painful process of major energy price adjustments and scaling back of public expenditures especially on development side during April–June 2008. The Federal Budget for 2008–09 clearly recognized the need for fiscal deficit reduction and indicated forcefully that economic adjustments especially in energy prices would continue. The Government also saw the need for strengthening incentives for agriculture and boldly increased the wheat support price.
>
> Despite warnings, however, it did not recognize the seriousness of the foreign exchange position and failed to develop a clear plan to deal with rapidly declining foreign exchange reserves. It seemed that for nearly six months, April–September 2008, the government was either in denial about the huge foreign exchange crisis it faced or unrealistically hopeful about very large financial support it could receive from friendly governments notably, USA, Saudi Arabia, China, and Japan, to tide over its foreign exchange difficulties.[32]

Given the economic problems being faced by the economy in 2008, particularly the fall in foreign exchange reserves and the growing balance of payments problems, the government in November 2008 turned to the IMF for a Stand-By Agreement eventually worth \$11.6 billion—see Chapter 17.

Box 18.10

Was the Economy Perpetually in Crisis from 2008 Onwards?

The dominant narrative of numerous writers since 2008, was that Pakistan's economy was in crisis soon after the People's Party government came to power. This newspaper article examines this claim.

A number of writers, some well-trained economists, others amateur and untrained at economics, have been writing regular articles in the press, including this newspaper, perhaps for the last three or four years, arguing that Pakistan's economy is not just in bad shape, but is in very serious trouble. Many of these writers were senior, high profile and prominent vocal members of the Musharraf-Aziz government, while others belonged to earlier governments.

One such writer, Ashfaque H Khan, a key member of the Musharraf economic team, wrote in this newspaper very recently, that "there is a general consensus within and outside the country that the economy of Pakistan has never been in such a bad shape since its inception in 1947. Pakistan has faced serious difficulties off and on over the last 64 years but has managed to sail through because of a competent economic team and strong leadership. Now there is a general view in the country that such leadership and economic team are missing today. It is for this reason that the people of Pakistan are nervous about the future outlook of the economy". Another contributor to this newspaper, a former Governor of the State Bank of Pakistan, Muhammad Yaqub, wrote something very similar stating, that "there is a near-unanimous professional view outside official circles that the economy is in a very bad shape. The political leadership is unable or unwilling to understand the depth of the economic troubles and is busy with its usual business, as if all is well on the economic front. For public consumption, government representatives talk about becoming self-reliant or depending on trade rather than aid, without evolving a strategy to do so." He also wrote, that "the real threat to the survival of the country was not from India, the US or from terrorism, but from an economic collapse that may be closer than people think if certain policy actions are not taken".

Maleeha Lodhi, another core member of the Musharraf decade, and by no means an economist, has also written, that "unending political turmoil in the country has brought the business of government to a standstill. Nowhere is the paralysis more consequential than in its impact on a sinking economy. With political leaders' attention distracted from governance, economic risks are multiplying. The downward economic spiral is being reinforced by uncertainty and the government's failure to address the challenge of structural reform. Whatever the political outcome of the confrontation between the government and other state institutions, a protracted stand off can accelerate the country's descent into economic chaos." She also likened the economy to a "runaway train hurtling towards derailment, with little to stop a train wreck".

These are just three vocal and prominent voices who have been arguing that Pakistan's economy is heading for disaster—never been this bad in 64 years, according to Ashfaque H Khan; chaos, paralysis and sinking, and a train wreck, according to Maleeha Lodhi; economic freefall, crisis and collapse, for Muhammad Yaqub—but there are many others as well. Many of those who have been the strongest critics of the present government's economic team and its policies were the more important representatives of the Musharraf regime. One who now writes an occasional newspaper column, while criticizing the present regime, has suffered a convenient case of amnesia, as he actively tries to distance himself from many of the disastrous policies he supervised under Musharraf. Most of those who have been writing about such catastrophic happenings, not surprisingly, do not belong to the incumbent government. In fact, one sees very partisanal voices in damning or defending Pakistan's economic record and performance over the last four years. So committed are some of these writers to show how disastrously the present government is performing compared to the one they represented, that they tend to repeat and reproduce their arguments and articles every few months—one of them does a particularly poor cut-and-paste, rehash, job from previous articles. Is this simply a matter of ulterior motives and mal-intent, on the one hand, and blind faith or partisanal support and vested interests, on the other? Just how bad, then, is Pakistan's economy?

The first piece of evidence which counters all claims of doom, disaster, collapse, crisis, catastrophe, etc. which some writers have been making for the last three or so years, is that the economy has not collapsed, and is nowhere near catastrophe. This does not mean at all, that it is buoyant or vibrant or that it is doing well. All that this means is that the death of Pakistan's economy, announced repeatedly for many years, has been greatly exaggerated. In fact, while these writers continue to harp on the catastrophe chorus, the truth is that this fiscal year, the economy is expected to do far better than it did last year, better than many expected, despite all the problems listed below.

Many of the indicators the doomsayers cite to make their case are actually important economic indicators which can be used to analyse the state of the economy. They are correct in their analysis when they make the case, that inflation has been in double digits for every month this government has been in office, that the fiscal deficit is worsening and therefore, so is debt. They are also not wrong when they point out that public sector enterprises are in poor state, or that a power crisis continues to get worse, affecting investment. Again, their argument that exports have not increased significantly and that the tax-to-GDP ratio has fallen further, are also correct. Other indicators are also cited to make the case that the economy has, or is on the verge of, collapse and disaster. Yet, despite pointing out these negative trends, the economy has not collapsed. Not only that, alternative sets of indicators can also be shown which suggest that the economy is not as bad as many of these writers make it out to be. There are such trends in the economy, which show that certain sectors are doing much better than they have in the past. Rural incomes

seem to be going up, consumer goods are in wide demand, banks have made very large profits in 2011 at a time when the doomsayers were arguing that all was despair, and so on. Some large banks had annual profits for 2011 in excess of 57 per cent, while the domestic production of cars, jeeps and motorcycles had increased by more than 8 per cent in the last six months. These are not indicators of a train wreck or freefall. There are other numbers as well which counter the sky-is-falling claim. Clearly, there is a major disconnect somewhere.

The critics of the government use six or seven key macro indicators to make their case for the collapse and catastrophe, train wreck, argument. Yet, there is much more to the real, actually existing economy of Pakistan, than just the fiscal deficit or the current account. Unless they have a better understanding of the micro and meso level of the economy, they will not realize why it is that Pakistan's economy seems to avoid complete collapse. In East Asia in 1997, soon after the economic crisis, it became immediately visible that the economy had crashed badly. One can see the same in Greece and other countries even where there has been a soft downturn. One sees no empirical or even wide descriptive evidence which shows anything similar in Pakistan. Why is it that the poor numbers at the macro level are not being reflected in any marked deterioration in the lives of most Pakistanis?

A criticism of those who argue that Pakistan's economy is collapsing must not be seen as an endorsement or argument in support of this government's economic policy. This government has failed miserably at providing a well-thought through economic policy. Its economic team is a complete failure and there is little disagreement with the group of people who criticise the government's economic programme. Yet, these critics need to re-read their own articles written over the last few years and to reassess their own biases and opinions. Their constant clamour of doom and collapse continues to be proven wrong, time and time again. They need to put their political biases aside and examine how the economy works. They have to be more honest in their assessment about why Pakistan avoids the sort of disastrous scenario which is emphasized in every article written by them. Perhaps the non-formal and parallel economy offers the answer to these questions, perhaps the textbook analysis which they use does not really capture real economic relationships and processes in Pakistan. Whatever it is, in order to answer just how bad Pakistan's economy really is, we need a far better, much wider and, most importantly, more honest and unprejudiced analysis.

Source: Zaidi, S Akbar, 'Just How Bad is Pakistan's Economy?', *The News on Sunday*, Karachi, 25 March 2012.

The authors of the Second Annual Report of the Institute of Public Policy in 2009 argued, that 'possibly a recourse to IMF could have been avoided if the caretakers and the new government would have taken bold and urgent actions to restore confidence among domestic and international investors. But it must also be stressed that an unexpected further steep rise in the international prices of oil and the persistence of high other commodity import prices notably wheat, palm oil, and fertilizers, made the external gap extremely large during April to September 2008 and basically unmanageable'.[33] It must also be remembered, that a consortium of countries, most of whom were involved with the US in the War of Terror, emerged to form a group called the Friends of Pakistan, a group which was supposed to come to Pakistan's assistance in terms of financial and economic help on account of the role played by Pakistan in the War on Terror. These Friends of Pakistan worked through the IMF rather than directly. Although large amounts of funds were promised by these Friends, it seems that the IMF Stand-By Agreement became available instead of the promised funds from the Friends of Pakistan.

It was recognized that the consequences of an IMF stabilization programme may slow down growth, as they have done in the past, and may affect poverty and employment in the long term. One must concede the fact that the Pakistani government, once it chose not to undertake reforms, under the worsening circumstances, may not have had a choice in having to turn to the IMF soon after taking office in March 2008. The stability in the economy in 2009 was a result of taking severe measures to stabilize the economy under the IMF programme. Although certain conditions in agreements with the IMF—especially the removal of subsidies on utilities—clearly made the situation far worse in the immediate term. Due to the IMF Agreement, there was a rise in the administered prices of petroleum products, power and of gas, all of which had a considerable additional impact on inflation.

While macroeconomic indicators relating to the fiscal and external sectors did show an improvement since the adoption of the IMF programme, the performance of the real sector slowed down considerably. The real GDP growth for 2008/09 was a mere 1.2 per cent compared with 3.7 per cent in 2007/08. The industrial sector witnessed negative growth, while respectable growth in agriculture and the services sector rescued the GDP growth in 2008/09 from falling into negative territory. The IMF Stand-By Agreement gave support to an economy which was faced with many challenges and some of the less troublesome aspects of the Agreement were adhered to by the PPP government. However, when more difficult measures had to be taken, such as the imposition of a Value Added Tax in the guise of a Reformed General Sales Tax (RGST), the agreement with the IMF had to be cancelled.

While there was a sense of stability due to the IMF programme for the 2008–10 period, the authors of the Institute of Public Policy's Third Annual Report of 2010 conclude, that 'while the program has helped in containing aggregate demand through contractionary monetary and fiscal policies and thereby limiting the demand-pull inflation, the opposite effect has been exerted through cost-push inflation, especially by the hike in energy prices'.[34] If there

Box 18.11
The Need for Reform

Just because one can make strong arguments that Pakistan's economy is not as bad as many newspaper columnists make it out to be does not mean that the economy is in good shape and does not need urgent and continuous reform.

Even the best of economies requires reform and adjustment periodically. Even when economies are working well some degree of tweaking here and there ensures that they continue to perform well. Economies cannot—should not—be left on remote control. The Hidden Hand can destroy any successes created by government policy and can cause economies to self-destruct.

Economies need constant review and overview. They need reform whenever they are performing at sub-optimal levels rather than before they reach the point where they begin to unravel. Pakistan's economy, while nowhere near the brink, is in need of major reform for it to be able to respond to numerous problems.

There are at least two ways of assessing how well—or not—an economy is performing. One is to be able to estimate some kind of potential growth and development path which the economy ought to be on if all things were working well. In times of economic dysfunction and in the absence of what could be called economic policy, if Pakistan's economy continues to deliver at least three to four per cent growth, it implies that with substantial government interest the growth rate could be markedly improved.

If with prolonged and excessive interruptions of power supply, floods in two successive years, a hostile domestic security environment, political instability and uncertainty, and a host of other factors, the economy still achieves in excess of three per cent GDP growth rate per annum as is expected this year there is no reason why the growth rate cannot be doubled.

This is the main purpose and function of economic policy and of the ability and quality of leadership, both economic and political. The case can be made that Pakistan's economy is severely underperforming primarily because of the absence of government direction and policy.

Another measure to assess how well an economy is performing is comparison with other, somewhat similar countries. While India feels that it is doing well with its consistently high growth rates over prolonged periods, it always asks the question why China is doing so much better. India's growth rate has been over seven per cent for many years now, but economists feel that it can do much better, largely because China does even better. Similarly, with so many countries in the region doing so much better than Pakistan, one can make the case that perhaps Pakistan ought to be doing much better as well.

Clearly, while one can argue that Pakistan is a special case and because of this is not doing so well, one can make the same argument for many other countries which are performing better than Pakistan. The 'special case' argument can be used occasionally, but not forever, especially when other supposedly basket cases tend to outperform Pakistan. What matters is how governments and leaders are able to respond to and deal with any sort of crisis or situation having an impact on the economy.

All countries have some form of comparative advantage, which could include mineral or natural resources, human capital, locational advantages and a host of special circumstances. What matters is how these conditions are used to one's advantage.

There is no reason why Pakistan cannot have sustainable high growth rates for prolonged periods of time if better use of its numerous resources were made.

The key missing ingredient is government policy or reform. Of course, there are tangible and substantive reasons why Pakistan's incumbent government has failed miserably at increasing economic growth, but complacency, denial and short-sightedness have played an important role.

One of the main features of the almost four years of this government has been its inability to prioritise a number of tasks which have required urgent responses. As a consequence, the economy has suffered. Of course, some interventions by the government have been well-focused and timely, such as raising purchasing prices of key crops and improving economic ties with India, emphasizing the argument that with greater direction and focus many more thoughtful interventions could have improved the economy substantially beyond its present low rate. Had reform taken place in 2008, despite the problems faced since then, Pakistan's economy would have performed far better than it has.

There is little doubt that Pakistan's economy has performed poorly for some years now, and one reason for this is the absence of reform. Numerous analysts have given long lists of what needs to be done with Pakistan's economy and it is not as if the government does not know. Reforms require leadership, vision and a plan. This government has shown that it does not have any of these and reform of the economy has not been a priority of the government.

This remains the main reason why Pakistan's economy continues to muddle through, a few per cent growth rate here, some remittances and loans there and little more. Left to itself, the economy will never reach anywhere near what could be its potential. Without active engagement and reform, we should expect more muddling through for a long time to come.

Source: Zaidi, S. Akbar, 'Missing the Point', *Dawn*, Karachi, 9 December 2011.

was any sign of stabilization, in 2010 another catastrophe hit Pakistan in the form of the worst floods in Pakistan's history. Over 20 million people were affected—more than the Asian tsunami of 2004 and Kashmir earthquake in 2005 combined—and at its height, flood waters covered a fifth of the country. Without a doubt, these were the most severe floods to hit Pakistan since independence in 1947. The Indus River and its tributaries began to overflow in late July 2010 and flooding continued through August. As the levels rose, people were displaced within provinces and sought refuge

in the nearest large town. The floods wiped out villages—nearly two million houses were damaged or destroyed—infrastructure, and agricultural land. By washing away roads, bridges, communication networks, powerhouses, and livestock, this destruction devastated the livelihoods of many Pakistanis. And it is the relatively poor and farmers who suffered the most. Government of Pakistan estimates were that the 'floods wiped out about 2 percentage points from the growth as well as inflicted a massive damage of $10 billion on country's [sic] economic structure'.[35] Floods again, in 2011, caused further damage, but far less than in 2010.

As Table 18.1 shows, growth rates in Pakistan fell from more than 6 per cent in the 2002–07 period, to half that during the tenure of the PPP government which came to power in 2008. Every single indicator for the economy worsened in the years after 2008. The inflation rate remained in double digits rising to 25 per cent at times, growth rates fell, and the fiscal deficit rose, Foreign Direct Investment fell considerably, as did the tax-to-GDP ratio. Critically, both the total investment as a percentage of GDP was down to around 12 per cent and the savings rate also fell to a mere 9.7 per cent in 2011/12, probably also the lowest ever. The narrative of the crisis mode, which was so dominant over the 2008–13 period must, surely, have been significant and of substance—see Box 18.10.

Yet, before we respond to the claim of the crisis narrative, let us also list some of the severe problems the PPP government was facing. First, it inherited a huge burden of poor policies, or the lack of decisions and policies, from the Musharraf and Caretaker governments. Second, the government after 2008, faced an international recession, extremely high oil and food prices, resulting in severe inflation at home as well as a deteriorating rupee. Pakistan faced the worst floods in 2010, and again in 2011. There was also the costs of the War on Terror, where not just the direct costs harmed Pakistan with terrorist attacks and insurgency in the country, but also because Pakistan became an inhospitable place for business. There was also a power crisis in the energy sector, where the consumer boom of the 2002–07 period lead to high consumption of energy resources, but little increase in the production of electricity. These economic problems were compounded by the issue of political transition, from a military government to a democratic one, and with the threat and fear of being dismissed by either the military or the Superior Judiciary, the President, his Prime Ministers, and their Cabinet, had much to deal with and respond to. By any sense of the imagination, the government after 2008 was not just challenged, but constantly under attack. Does this absolve it of responsibility for bringing the economy to the level it did, or does one argue that despite these problems, the fact that no real crisis emerged and the economy did not collapse, suggest that one should give the PPP government some credit?

Regardless of the scale of the challenges and problems that the PPP government had to face, there is little denying the fact that there was a great deal of mismanagement by the economic team in handling the economic situation. At times, there was confusion which substituted for economic policy, at others, the government's economic policy was conspicuous by its absence. In the first three years of the PPP government, there had been four Finance Ministers, three Governors of the State Bank of Pakistan, and four Finance Secretaries, signalling a clear mismanagement and the absence of understanding to give the economy priority and direction. It is true that for much of its tenure, the Zardari presidency and the PPP government were just trying to survive and stay in office against conspiracies, threats and terrorism, and perhaps the economy never received the priority that it should have. Even going to the IMF was a sort of a strategy, where the government felt that it would be easier to undertake some reform under the shadow of the IMF, rather than take full ownership for the reform process. For the most part, while the PPP government will be remembered for many interventions in the political process and for a number of bold constitutional measures—such as the Eighteenth Amendment and the National Finance Commission Award—it will not be remembered for undertaking any reforms in the economy.

Those who hammered the 'collapse-and-crisis' mantra were not wrong in citing many of the statistics they did, as we have shown above, where all key statistics deteriorated in the 2008–13 period. Clearly, these indicators reveal an economy which performed poorly. However, these economists—and many non-economists ignored the numerous factors which prevented a crisis situation from emerging.

Two speculative reasons requiring much more rigorous analysis can only point towards addressing these issues. While ideas about the informal sector or the black or underground economy abound, there has been little research done on how Pakistan's wide social and economic networks allow families and individuals to live in worlds which are often not on the economist's map. Similarly, what has also not been analysed in recent years, is how remittances have allowed numerous families to weather the storms created by the economist's statistics of doom and gloom. Many economists fail to understand how Pakistan's economy really works, and why it continuously avoids any real crisis. They use a few select facts of data to make their point. The key question for economists trying to understand Pakistan's economy, is not whether the economy was nearing collapse, but *why it did not collapse*, given so many deleterious circumstances. While the oft-repeated cries of 'collapse and crises' now sound terribly repetitive and boring, what would make more interesting and relevant analysis, is why and how Pakistan manages to *avoid* an economic crisis. The truth is, we really don't know enough.

18.8 Summary and Further Reading

18.8.1 Summary

This chapter has highlighted events and developments on Pakistan's political and economic map since 1998, and has shown that the period since then, has had rather more than its share of drama, even in the case of a country like Pakistan, where drama and theatrical performances have been commonplace. Within this period, Pakistan has had a military coup, gone public on its nuclear capabilities and

professed nuclear ambitions, been near to being declared a rogue state, been even nearer to being declared bankrupt, almost having gone to war with its neighbour, and having emerged as a champion in the War on Terror, whether in Afghanistan or Iraq. And all this, within a few dozen months!

With the backdrop of domestic, regional and international drama, Pakistan's economy has had two major disruptions in trend. The first took place in the late 1990s, after the May 1998 nuclear tests and a freeze on the Foreign Currency Accounts resulting in a meltdown of the economy, with a grave balance of payments and foreign exchange crisis, backed with a serious crisis of trust. While economic performance throughout the 1990s had been particularly poor, events towards the end of the decade only worsened them. Nuclear and democracy related sanctions did not help much either.

However, the world changed after that, and Pakistan reaped much reward from supporting the US War of Terror in Afghanistan and Iraq—see also Chapter 25. Suddenly, a pariah nuclear and undemocratic nation was back in the folds of international and global capital and now, once again, a member of the civilized world. Pakistan's reward was a debt write-off, debt rescheduling, more room for exports, greater remittances, and as a result, the economy started picking up once again. However, the chapter does question the official celebrations that there had been a 'turnaround' in the economy and that Pakistan's economy was on the path of robust growth.[36] Since much of the 'turnaround' came on the back of fortuitous external factors and windfall gain, it became difficult to conclude that the upturn had begun. For any serious and particularly, sustainable, improvement to occur, far deeper institutional strengthening would have been required, as we found out very soon after the fall of the Musharraf regime. It became clear towards the end of the Musharraf regime, that growth and the economic boom were built on weak structures, that little reform had taken place, and that political decisions were more important than economic ones. The PPP government in 2008 inherited numerous problems created by the Musharraf and Caretaker governments. Moreover, numerous external factors, such as the oil and food price rises, economic recession in the developed countries, the security situation internally on account of the War on Terror, and damaging floods, all added to the troubles of a democratic and political government dealing with transition from nine years of military rule. While these 'bad luck' factors, similar to those which Zulfikar Ali Bhutto's government faced in 1971–77, had an impact on the PPP government, one cannot absolve the government for taking poor decisions and for mishandling the economy. While there are many factors which led to the poor performance of the economy under the Pakistan People's Party government, poor administration and management, must top the list.

18.8.2 Further Reading

Since the theme of this chapter is very topical, newspapers are a good source to read up on what all has been happening in the economy, as are frequent bulletins and statements put out by the IMF, World Bank and the Asian Development Bank. Much of this and related material is now easily available on the web. In addition, the annual *Pakistan Economic Surveys* are very useful, but even more helpful are the revamped *Annual Reports* of the State Bank of Pakistan. These Annual Reports, especially since 1999/2000, provide excellent insight, and are also highly analytical and not just run-of-the-mill government publications. Papers published in *The Pakistan Development Review* and, in particular, in the annual issue which contains papers presented at the PIDE Conferences are useful and should be consulted. Although there have not been many books which examine the state of the economy under Musharraf or after, without doubt, the best and most thorough analysis based on extensive empirical analysis, comes in the form of the *Annual Reports* of the Institute of Public Policy at the Beaconhouse National University in Lahore. Another equally good source is the *Final Report of the Panel of Economists: Medium-term Development Imperatives and Strategy for Pakistan*, commissioned and produced by the Planning Commission, Government of Pakistan, April 2010. The *Pakistan Millennium Development Goals Report 2010: Development Amidst Crisis* (Islamabad: Planning Commission, Government of Pakistan, 2010) also contains some of the material which is covered in this Chapter, although it focuses on the impact of the economy on the social sectors. In addition, see some excellent analysis in: Rashid Amjad and Shahid Javed Burki (eds), *Pakistan: Moving the Economy Forward* (Lahore: Lahore School of Economics, 2013).

19 The Social Sectors I: International Comparisons, Education, Population, Urbanization, and Housing

Almost without exception, every publication, whether by the government or by scholars and social scientists, laments the state of the social sectors in Pakistan. The high growth performance of nearly 5 per cent per annum over many decades, is acknowledged, but at the same time, the rather dismal state of the social sectors is also highlighted. The arguments usually presented state that most governments and the public sector have ignored the social sector and not given it enough importance or resources. We will argue that despite the lip-service paid to the need to develop the social sector, this situation continues a decade into the twenty-first century, with resources not substantially increased to different components of the social sector. Nevertheless, the more interesting question is not how the social sector has continued to remain underdeveloped, but how, with such an underdeveloped social sector, and extremely low literacy rates, for example, the economy has shown such resilient growth. If the social sector is in as bad a state as almost all observers believe, how has the economy continued to grow at an impressive rates? This leads to another question: can a less developed social sector continue to produce high growth, or has a time now came when growth will be highly dependent on human capital formation, as the New Growth theories suggest?

Indeed, these are interesting and important questions, the answers to which may be difficult to find. While not being able to explain how high economic growth has coexisted with very low social sector development, there is now a growing consensus that this pattern may have been one of the past, and that now there is an urgent need for a highly skilled, educated, and healthy workforce and the population to deal with open trade barriers, new technology, and the maximization of all human potential, especially when governments speak of the youth bulge, or demographic dividend. This view examines the record of countries like South Korea and Taiwan, and more recently of Malaysia and Thailand, and argues that, without social development economic growth and development can no longer take place. While there is growing evidence that this may be the case, one must ask whether Pakistan's élite, bureaucrats, generals, and leaders have learnt any lessons from the Pacific Rim and East Asian countries. Has there been any shift at all in approach towards the social sectors? Or has the old, tired rhetoric, merely been repeated *ad nauseam*? Moreover, we argue that one reason why Pakistan's social sectors are poor is because the élite has set up its own private institutions, leaving the rest to the less affluent. There has been an elite flight from public institutions, resulting in poor services for the non-elite.

This, and the next two chapters, will try to examine the existing conditions—the facts—and the issues in a number of important constituents of the social sector. We will provide figures and show trends over time, examining the nature and impact of those trends. Some attempt will be made to examine the nature of issues, problems, and successes in different areas. Chapters 19 and 20 present data and information about a number of social areas, followed by discussion of the salient features of these subsectors while Chapter 21 examines the health sector. A new section, Part 8, has been added to the Third Edition of this book, with a chapter on Poverty and Inequality, which should be read along with Part 7. Chapter 22 deals with the growing and severe problem of poverty in Pakistan, along with the considerable debate over the extent of poverty in Pakistan, while Chapter 23 highlights the extent of inequality, both regional and income, in Pakistan. In this chapter, we begin with a comparison of Pakistan's social sector indicators with that of other countries, many of which are in the South Asian region or have similar levels of development.

19.1 Some International and Regional Comparisons

It is probably not very wise to compare countries. There are too many specific factors—history, culture, governments, institutions—which may influence events and consequences in very special and specific ways. The context of each event or development must be recognized and appreciated. Often, standards of a very alien kind are imposed across a general universe, which may result in numbers or results that are not comparable. Even the so called scientific criteria are not insensitive to their social environment, and even simply counting and comparing 'obvious facts' can be hazardous. Hence, there are numerous problems in taking a set of indicators showing the state of the health of the economy and comparing them across countries. Nevertheless, these comparisons continue to be made and there is a huge industry which churns out PhDs and tomes on indicators comparing diverse nations and countries. We too, despite our criticism and concerns, continue that tradition in order to indicate some salient trends.

In this section, we examine Pakistan's performance in the social sectors with that of other developing countries. While

it is difficult to make comparisons across countries, it is possibly more difficult to find some countries across which comparisons can be made. In our choice of countries—see Table 19.1—all eight countries belong to the World Bank's classification of Low Income Countries, i.e. those with a per capita GNP of less than US$730 based on 1993 data—this year is chosen to see how well or badly countries performed over two decades.

While the low income status may be the first criterion for our selection of countries, there are some others as well. India, Bangladesh, and Sri Lanka share similar histories and belong to South Asia, and are also grouped together in the South Asian Association for Regional Cooperation (SAARC), and hence, can have some valid grounds for comparison. China is included because it is a key player in the region, and used to have a GNP per capita close to that of Pakistan's, and is cited by many as a country where communist led growth and development in the past has resulted in an egalitarian social structure with extensive social development. The new China with its liberal and open economic programme—like much of the rest of the region—also makes it worth observing. Ghana and Nigeria, while very different from the Asian countries are included because they have large populations (Nigeria), and Ghana had a GNP per capita (in 1993) close to or equal to Pakistan's. Also, like the four South Asian countries, they have both been under British Colonialism, and hence some comparison is probably permissible. The outlier is Vietnam, which is included because it is still a Socialist state (like China), but has not had as many year's of capitalism as China; and despite having a per capita GNP of only 40 per cent of Pakistan's (in 1993), has some very interesting and revealing social indicators. Possibly, GNP per capita, as is often assumed, may not be the sole, or even the key, criterion for social development. Political commitment, structure, and involvement may be equally, if not more, important.

Table 19.1 is not easy to interpret, indeed, if there were any interpretations which could be made from it. There are no conclusions or hard overriding truths which emerge from the table, simply observations open to conjecture. Table 19.1 presents the pattern and trend of human development in Pakistan during the 1990s, before examining trends in recent years.

The first row gives the GNP per capita for each of the eight countries in US dollars for 1993, followed by the second row which shows the GNP per capita for 2011. These rates indicate the rate at which countries have grown over the 1993–2011 period. China's example is significant, where in just a few years it increased its comparative and absolute position: In 1980, China had a GNP per capita of $206 compared to Pakistan's $285, and was one of the poorest countries in the world. With a phenomenal 8.2 per cent average annual growth rate over many decades, it improved its position markedly. While China, Sri Lanka, Vietnam, India, and even Bangladesh, had all substantially improved their per capita GNP values in the 1990s, Pakistan, Ghana, and Nigeria had not. Rather than be part of the dynamic growth trends of East Asia which were being mirrored amongst countries of South Asia, *Pakistan increasingly looked like a poor, underdeveloped, African country in 2002*. In the two decades 1993–2011, Pakistan had the lowest increase in GNP per capita, by only 2.6 times, compared to China (10.1 times), even much lower than Bangladesh, India, and Ghana.

The GNP per capita rank lists the position on the basis of GNP per capita these countries have in the world; Vietnam was the fifth poorest country in the world with a GNP per capita of only $170 in 1993, and Pakistan, with a GNP per capita of $430 was the 31st poorest country out of the 132 then classified by the World Bank. It is interesting to note from this comparison of ranks of GDP per capita in 1993 and 2011, is that in line with improvements in absolute levels of GDP per capita, those countries which have done well in 1993–

Table 19.1: International Comparisons of the Social Sectors

	Pakistan	Vietnam	Bangladesh	India	Nigeria	Ghana	China	S Lanka
GNP pc 1993 $	430	170	220	300	300	430	490	600
GNP pc 2011 $	1120	1270	780	1420	1280	1410	4940	2580
Increase in GNP pc 1993–2011	2.6	7.4	3.5	4.7	4.3	3.3	10.1	4.3
GNP pc rank 1993 *	31	5	12	20	21	30	33	39
GNP pc rank 2011 *	38	43	27	49	45	48	92	61
HDI rank 1993 **	128	120	146	134	141	129	111	97
HDI rank 2012	146	127	144	136	153	135	101	92
Literacy rate 2001	44.0	92.7	40.6	58.0	65.4	72.7	85.8	91.9
2012	54.9	93.2	56.8	62.8	61.3	67.3	94.3	91.2
Female literacy 2001	28.8	90.9	30.8	46.4	57.7	64.5	92.5	89.3
GDI rank 2003 +	120	89	112	103	124	104	83	80
GDI rank 2012	123	48	111	132	NA	121	35	75
Poverty Index rank #	65	39	72	53	54	46	26	34

Notes: * The higher the rank, the better—the poorest country is ranked 1; ** The lower the rank the better—the best country is ranked 1 and the worst 175; + Best ranked 1, worst 175; # Best ranked 1, worst 74.

Source: United Nations Development Programme (UNDP) *Human Development Report* (New York: UNDP, various years); and The World Bank, *data.worldbank.org.*

2011, have also done relatively better than other countries. While Vietnam was the fifth poorest country in 1993, it is now the 43rd poorest, showing considerable improvement, while Pakistan improved its rank only marginally. In contrast, comparing China, India, and even Ghana's improvement, only Bangladesh did worse than Pakistan.

While GNP per capita is a very simplistic and crude (yet indicative) measure of social development, the Human Development Index (HDI) is a larger and a broader composite indicator which captures much more than just per capita income. The HDI contains three indicators: life expectancy, representing a long and healthy life; educational attainment, representing knowledge; and real GDP (in purchasing power parity dollars), representing a decent standard of living. The Human Development Index shows:

> How far a country has to travel to provide these essential choices to all its people. It is not a measure of well-being. Nor is it a measure of happiness. Instead, it is a measure of empowerment. It indicates that if people have these three basic choices, they may be able to gain access to other opportunities as well. The HDI, imperfect though it may be, is thus a viable alternative to GNP per capita, and it is increasingly being used to monitor the progress of nations and of global society.[1]

Thus, the HDI in Table 19.1 for the selected countries, unlike the GNP per capita, shows a reverse order: the higher the number the worse the nature and extent of social development. Using the HDI, Pakistan's rank in 1993 was 128th out of 174 countries showing (a lack of) social development, but had fallen further to 146th position in 2012, mirroring the worsening trend in per capita income. In our sample, Sri Lanka in 1993, was the best of the eight countries selected (97th) and Bangladesh (146th) the worst; two decades later Sri Lanka still remains the best at 92nd position, while Nigeria has become the worst in terms of HDI ranking. Again, Pakistan had fallen by as *many as eighteen positions down the HDI ladder* between 1993 and 2012.

Not only did Pakistan's social and human development worsen, but so did its comparative position with regard to other countries. In terms of HDI performance, the worst 45 performers—from rank 142 to 186—were almost all African countries. In the lowest HDI category called Low Human Development, of the 45 countries, only five were outside of Africa. Pakistan *at position 146, happened to be one of them.* Pakistan's human and social profile after the decades of Democracy and Structural Adjustment, looked more like that of poor African nations, rather than that of South Asian or Latin American states. Even Bangladesh and Bhutan had better human and social statistics than Pakistan. Of the 186 countries in 2012, the best five performers were: Norway, Australia, United States, the Netherlands, and Germany.

The next segment in Table 19.1 contains one of the most important statistics cited for social development, that of literacy. Overall adult literacy (and importantly, female literacy) is considered to be a fairly good indicator which reveals the true status of social development in any country. In New Growth theories, where human capital formation is an essential component and prerequisite for growth, literacy acts as an important proxy for many key ingredients. Also, with the need for more skills in the present electronic and computer age, with increasing importance on competition and quality, education and literacy have become even more important.

Vietnam, with a GNP per capita about the same as Pakistan's, had education statistics which would put many developed high income economies to shame, as would Sri Lanka. All the four poorest countries in our sample based on 1993 GNP per capita data, outperformed Pakistan very significantly. Even Bangladesh, which many in Pakistan saw as a country with few prospects, did far better than much wealthier Pakistan. Some 91 per cent of Vietnamese, and 91 per cent of Sri Lankan, women were literate, while only 29 per cent of Pakistani women could read or write. All Sri Lankan girls aged 5–9 were in school, while only half of Pakistani girls were in school, and even Bangladesh had an impressive record in this area. Bangladesh and Pakistan were again, the worst performers when it came to labour force participation by women: only 8 per cent of Bangladesh, and 13 per cent of Pakistani women, were in the labour force, compared to 47 per cent for a very poor, Vietnam.

The gender-related development index (GDI), an index created by UNDP, measures the inequalities between men and women capturing differences of life expectancy; adult literacy; primary, secondary and tertiary enrolment rates; and a standard of living. The GDI in Table 19.1 shows that out of 175 countries in 2003, Pakistan and Nigeria performed the worst in our sample, while in Sri Lanka and China, the gender difference between men and women was less severe.

Poverty indicators in Table 19.1 also show that the Human Poverty Index—which measures deprivations in terms of vulnerability to early death, exclusion from the world of learning and knowledge as measured by literacy, and lack of access to basic health and water amenities—shows Pakistan as one of the worst performers in the last third of the list of 94. It also has a poverty rate, like Bangladesh and Nigeria, where one-third of the population is below the national poverty line.

It is difficult to reach any definite conclusions from the myriad of data presented in Table 19.1. However, some general observations can be made:

1. Pakistan's economic and social and human profile over the period 1993–2012, looked increasingly like that of African countries, rather than that of South or East Asia.
2. All countries in our sample saw their per capita income rise in the 1993–2012 period, but Pakistan had the smallest rise.
3. Pakistan's literacy rate was abysmally low. All other countries had better literacy rates.
4. Pakistan's performance is better in terms of health, although with one of the highest population growth rates in the world, problems may occur in the future.
5. Almost all indicators regarding women, showed Pakistan as the worst performer, revealing excessive and unacceptable levels of gender discrimination.

Although there are many contested explanations why this was the case, the decade of the 1990s was indeed the Lost Decade for Pakistan, with poor economic and social development, not just in absolute terms, but compared to many similar countries in the region and around the globe. The question, whether the economic turnaround between 2002–07 resulted in any improvement of social and human development as well, is answered below.

It seems then that despite having a high economic growth performance for many years and outperforming other countries in the economic field, Pakistan's social development has been particularly poor. Even less developed and poorer countries measured on an economic scale have developed their social sector well ahead of Pakistan. From our evidence, one may surmise that economic growth, or GNP per capita, may not be the most important ingredient for social development, and that political will and commitment may be equally important. Pakistan's economic prosperity is contrasted sharply with its poor social development. Some facts, trends and issues are elaborated in subsequent sections. In the next section, we examine the impact of the high economic growth during the Musharraf government in the period following 9/11, between 2002–07—see also Chapter 18 for a more detailed analysis of macroeconomic developments during this period.

19.2 The Impact of Economic Growth 2002–07

At some point between 2002 and 2004, Pakistan entered the United Nations Development Programme's (UNDP) classification of those ninety or so countries which the Human Development Report (HDR) classified as 'Medium Human Development'. Since 1990, when the UNDP initiated its annual HDRs, Pakistan was consistently classified as one of the forty or so countries in the 'Low Human Development' category. (As a comparison, both India and Bangladesh too, not surprisingly, were also originally considered in the Low Human Development category, but both moved into the Medium Human Development category well before Pakistan, towards the end of the 1990s). For many years, considered to be a 'middle income country with low human development', perhaps Pakistan was now moving in to the category which better reflected its economic and social characteristics. The fact that this elevation to Medium Human Development came at the beginnings of an uninterrupted four year period of economic boom beginning in 2002 with per capita income almost doubling in this short period, implied that perhaps Pakistan's Human Development status and its ranking in 2004 (134/177) may have improved considerably since then. However, once the Musharraf government bubble burst—see Chapter 18—Pakistan once again fell back in to the 'Low Human Development' category.

In this section of the chapter, we consider some recent trends in Pakistan's social development dealing largely with data from the UNDP's Human Development Reports HDRs, where some international comparisons can be made and where Pakistan's social and economic progress since at least the 1990s—when the HDR series was initiated—can be compared overtime using one consistent data set. Table 19.2 presents a series for Pakistan's HDI and shows its trend for a period of forty years.

Table 19.2 shows a number of statistics related to Pakistan's economic and social performance over some decades. Firstly, it shows that Pakistan's HDI value rose over the last three decades between 1975–2004 by 47 per cent. As a comparison, during the same period, India's value rose by 48 per cent, Bangladesh's by 53 per cent, and Nepal's by 76 per cent. In the 177 country sample, most countries showed an increase in the value of the HDI over this period, some at a faster pace, some slower. In Pakistan's case as well as many others, the value first rises, but then due to some shocks, falls, but then rises again. Many of the poorer African countries in the 1980s/90s depict this trend probably due to the two-fold crises, that of structural adjustment and HIV/AIDs. Nevertheless, most developing countries show an overall progress over these three decades and Pakistan's record is no exception.

Between the period 1992–2004, Pakistan's rank fell from 128th in 1992 to 144th in 2001 and only recently improved, although Pakistan was still below as compared to where it was in 1992. Per capita income in purchasing power parity terms also fell sharply between 1992–2001, and rose again after 2001. From being the 100th country on the basis of per capita income in 1992, Pakistan's rank was 130th, or the 47th poorest country in the world in 2004. However, in terms of the overall size of the economy, Pakistan is the 44th largest economy in the world.

Table 19.2: Pakistan's Human Development Index 1975–2004

	1975	1980	1985	1990	1992	1994	1995	2000	2001	2004	2012
HDI value	0.365	0.388	0.420	0.463	0.483	0.445	0.493	0.511	0.499	0.539	0.515
HDI rank					128/174	139/175			144/175	134/177	146/186
Per Capita (PC) Income PPP $					2890	2154			1890	2225	2424*
PC Income Rank					100/174	120/175			137/175	130/177	148/186*
PC GDP $					420	373			415	632	1120*

Source: UNDP, *Human Development Report* (New York: Oxford University Press, various issues).
* for 2011.

To summarize, Table 19.2 suggests that during the 1992–2001 period, although there was an improvement in the HDI value by 12 per cent, other countries did far better than Pakistan (since its relative position—rank—deteriorated); Pakistan's per capita income fell as did its relative economic ranking in terms of per capita income. However, all these trends were reversed in the period 2001–04, when there had been considerable improvement. Moreover, given the fact that the period 2004–07 saw higher growth than in the past, with per capita GDP reportedly having reached $847 by July 2006, one can safely assume that Pakistan's HDI value and rank would both have appreciated even further.

19.2.1 Finally on Track?

What the evidence and data in the last section suggests, is that the 1990s, the Decade of Democracy in Pakistan, was the 'Lost Decade' in terms of social and economic development—or lack of it, and was the creation of underdevelopment, in relative terms—and that it was General Musharraf who gave back to Pakistan the high growth and development path to which Pakistan had been accustomed for some years. Is this indeed the case?

Evidence from the period 1947–77 seems to show that the trajectory of economic growth was not translated into a corresponding trajectory for human and social development and, equally, low human and social development was still able to support high levels of economic growth. In fact, in the 1971–77 period, despite low growth, we were able to see considerable reorientation in the delivery and expenditure on social development which must have led to a marked improvement in outcomes. Between 1977–88 high economic growth did cause an improvement in human and social development indicators, most noticeably in causing poverty to decline, yet this improvement in human and social development did not carry through to the 1990s and sustain the economic growth trend, and in fact, an economic slowdown resulted in a severe deterioration of Human Development Indicators in that decade. Despite the deterioration in human capital in the 1993–2002 period, the economy was able to pick up considerable speed following 9/11, a development which has led to an improvement in indicators in human development—see also Chapter 18.

The high growth/high human development in the 1977–88 period was matched by high development expenditure, with the 1980s being the decade with the highest proportion of the GDP allocated to development. Similarly, the 1990s were the period when, as a consequence of poor economic growth and structural adjustment, a restricted fiscal space allowed only 4.7 per cent of GDP to be spent on development. More interestingly, in the early Musharraf period where, as the economic slowdown from the 1990s continued, the development expenditure in the 1999–2005 was a mere 2.6 per cent, amongst the lowest ever. What do these often contradictory and conflicting trends suggest?

The first main observation from our data and discussion suggests, that there are different patterns and processes at work in the period 1947–77 and 1977–2007. In the first, economic growth (either high or low) did not seem to reflect the same sort of trend in the social and human sectors. In the 1977–2007 period, there does seem to be a trend in human development which is reflected in trends in economic growth. A key difference in the model and structure of the type of social development delivery in the pre- and post-1977 period relates to the extent of state involvement and that of the privatization of services. Pakistan adopted a far more open and market-based delivery mechanism for social services after 1977, and perhaps that is why we see a closer relationship between growth and human development. In a market-based system in which the state plays a secondary role, people's incomes will determine their access to health and education services: private sector spending in health, for example, constitutes 76 per cent of total health sector spending; at primary and secondary level education, one would expect similar trends. Hence, if social sector provision is market-based, one would expect incomes to govern access and hence, outcomes. This could be a possible reason why, in the post-1977 period, one sees a closer relationship between economic growth and human development.

Linked with the argument above, perhaps, is the argument of the impact of development expenditure and public policy, more broadly. In the 1971–77 period, there was active intervention in the social sectors as well as increased spending, despite low growth. It is probable that human development outcomes improved as a consequence in this dominantly public sector delivery mechanism. In the 1999–2005 period, despite the fact that development expenditure was abysmally low, since private incomes were rising, the market-based model was more responsive to people's incomes than to development expenditure, resulting in improved human development indicators. This analysis shows that since 1977, *private incomes determine human development outcomes, and increased development spending may not ensure better human development*. Even if this conclusion is partially correct, it has major repercussions on strategy for development in Pakistan—see also Appendix 19.1.

If human development outcomes are increasingly determined by the pace of economic growth and the rise in incomes, clearly, economic growth becomes critical for better human and social development. *Hence, if economic growth falters, so does the human condition*. And herein lies the Achilles heel of Pakistan's economic and social 'success' and where international relations and the security dimension comes in a forceful manner.

Both in the 1980s under General Zia ul-Haq and under General Musharraf since 1999, international powers—primarily, if not exclusively, the United States, along with international donors—have been more than generous in their support of military dictators in Pakistan when, on both occasions, Pakistan was fighting the US war on its Afghanistan border, as a frontline state. Under both military generals, Pakistan received financial and military aid, special privileges and grants, and political support to perpetuate their undemocratic rule over the Pakistani people. Largely on account of this support and financial aid, Pakistan's growth rates in these two eras—as they were under General Ayub, another beneficiary of US largess—soared compared to other periods—particularly the democratic ones. In the

War of Terror, General Musharraf, far more than General Zia, benefited immensely from the geopolitical events following 9/11—see Chapters 18 and 25.

Pakistan's economic growth, and as a consequence, its human development improvement, is based on these weak and fragile foundations. If Atlas were to shrug, or Musharraf not toe the Bush line, it would have been improbable that the growth seen in Pakistan in recent years would have continued for much longer. As it is, the trends related to Pakistan's economy suggested that the high growth of the 2002–07 period slowed down, largely because Pakistan's recent growth had been built on a spurt of excess liquidity, mainly in the form of remittances and transfers, much of which fuelled an artificial asset boom. As this 'boom' slowed down, the more fundamental issues of an unmanageable current account deficit and budget deficit, along with growing inflation, emerged and began to undo the economic gains of the recent past.

In a market-based model of social development, with the state on the retreat, such a slowing down in the economy had a deleterious impact on social and human development outcomes. In the context of Pakistan, we may have not seen the trend where increased human development increases economic growth—as in the East Asian model—hence only high economic growth can support improving human capital. Clearly, in the case of Pakistan, it is its international relations and regional and global security issues which determine human development outcomes through the linkages created by donor money and aid. Because of the precarious nature of the relationship between military dictatorship, compliance with US needs and demands in its War on Terror, and economic growth, Pakistan's model of social and human development, is not one to be recommended for other countries—see Chapter 25.

19.3 Education

19.3.1 Statistics

One of the most important statistics in the social sectors is the literacy rate, which acts as a proxy for a number of other indicators as well, and is therefore also one of the three indicators that form the Human Development Index. Pakistan's literacy rate is still one of the lowest in the world, and is worse than countries which have per capita GNP equal to or close to Pakistan's level—see Table 19.1 for a comparison. While the literacy rate has risen four and a half times since 1951 (Table 19.3), that for female literacy is still particularly poor. The repercussions of this are discussed in the section on women in Chapter 20. Moreover, there is such a marked regional and provincial differentiation that, just as in the case of doctors and the availability of health services, it is futile to talk about a single literacy rate for the country.

Table 19.4 shows the literacy rates from the 1972, 1981 and 1998 censuses, and indicates extensive regional disparity. While in Karachi the literacy rate was 55 per cent in 1981, it was only 8.2 per cent in Balochistan. The rural literacy rate for women in Balochistan was less than 1 per cent, possibly the lowest in the world. Although it has risen in recent years, in all the provinces in the rural areas, the literacy rate for women is still extremely low—see Table 19.4.

Data from the Social Policy and Development Centre's (SPDC's) *Annual Review* for 2011/12[2], shows that the Gross Enrolment Rate (GER) at the primary level for the whole of Pakistan is currently around 92 per cent, having risen from 69 per cent in 1992/93. Given the fact that fewer girls than boys go to school, it is encouraging to see that for girl's this rate had gone up from 52 per cent in 1992/3 to 83 in 2011, while that for boys had reached 100 per cent.

Table 19.5 shows provincial data for the Net Primary Enrolment Rate which is age-specific, and here the situation is worse than for the Gross Enrolment Rate. The Net Enrolment Rate (NER) had declined for boys, and risen slightly for girls although between 2002 and 2011 it has again risen considerably for both—see also Section 19.2. The Punjab stands out where there had been a marked fall in the NER, and even for the other provinces, the trends were not at all favourable. Worse still, was the huge increase in dropout rates during the period 1996–2000, showing startling trends where very few children (and particularly, very few girls) completed their education even at primary level. The enrolment rate at secondary school level since 1995 also shows worrying trends, particularly in the Punjab, although this has also now improved. Overall, the most promising trend seemed to be emerging in the NWFP, especially regarding boys.

The SPDC Report put forward a number of explanations for this overall downward trend. It showed that, for example, average growth in real recurring expenditure on education in the period 1997–2002, fell in the Punjab and in the NWFP, and grew in both Sindh and Balochistan, although it grew at a slow pace since 1975! In terms of average growth in provincial real development expenditure on education, in 1997–2002 it fell in all the provinces except Balochistan, falling by 13.30 per cent in the Punjab and by nearly 19 per cent in NWFP. In each of the four periods reviewed since 1975, real development expenditure on education, had been quite substantial. For Pakistan as a whole, during the period 1997–2002 real education expenditure increased by only half a per cent, while real development expenditure declined by

Table 19.3
Literacy Rates in Pakistan: 1951–2011/12

Year	Total	Male	Female
1951	13.2	17.0	8.6
1961	18.4	26.9	8.2
1972	21.7	30.2	11.6
1981	26.2	35.0	16.0
1990	34.9	45.1	20.9
1999/2000	47.1	59.0	35.4
2011/12	58.0	70.0	47.0

Source: Banuri, Tariq et al. 'Human Resources Development', in Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992), 34; Government of Pakistan, Ministry of Finance, *Pakistan Economic Survey* (Islamabad: various issues).

Table 19.4
Literacy Rates in Pakistan: 1972, 1981, 1998 (%)

Unit	Total			Urban			Rural		
	Both sexes	Male	Female	Both sexes	Male	Female	Both sexes	Male	Female
Pakistan									
2011	58.0	69.0	46.0						
1998	43.9	54.8	32.0	63.1	70.0	55.2	33.6	46.4	20.1
1981	26.2	35.0	15.9	47.1	55.3	37.2	17.3	26.2	7.3
1972	21.7	30.2	11.6	41.5	49.9	30.9	14.3	22.6	4.9
NWFP/ Khyber Pakhtunkhwa									
2011	50.0	68.0	33.0						
1998	35.4	51.4	18.8	54.3	67.5	39.1	31.3	47.6	14.7
1981	14.3	22.7	4.9	32.1	42.8	18.8	10.9	18.7	2.5
1972	14.5	23.1	4.7	33.7	44.7	19.9	11.0	19.0	2.2
Punjab									
2011	60.0	70.0	51.0						
1998	46.6	57.2	35.1	64.5	70.9	57.2	37.9	50.4	24.8
1981	24.5	33.5	14.4	43.1	51.5	33.2	17.3	26.4	7.4
1972	20.7	29.1	10.7	38.9	47.8	28.0	14.7	22.9	5.2
Rest of Sindh									
1998	33.4	45.00	20.4						
1981	21.0	30.0	10.0	–	–	–	12.7	20.8	3.4
1972	22.5	32.6	10.0	–	–	–	17.6	27.5	5.8
Balochistan									
2011	41.0	60.0	19.0						
1998	24.8	34.0	14.1	46.9	58.1	33.1	17.5	25.7	7.9
1981	8.2	12.5	2.9	27.9	37.7	14.3	4.4	7.3	0.8
1972	10.1	14.8	4.2	32.3	42.4	19.2	5.6	9.2	1.2
Karachi									
1998	67.49	71.1	62.9						
1981	55.0	60.0	48.8	–	–	–	–	–	–
1972	51.2	55.8	45.0	–	–	–	–	–	–

Source: Population Censu Organization, *Population Census Reports* (Islamabad: various issues); for 2011, Social Policy and Development Centre, *Social Development in Pakistan: Annual Review 2011–12* (Karachi: SPDC, 2012), 152.

11 per cent. Another explanation for low enrolment rates in Pakistan in the 1990s, could be the rise in poverty levels, with poverty rising from 17 per cent of the population in the late 1980s, to around 33 per cent at the end of the 1990s. SPDC's report shows, not surprisingly, that school enrolment rises as income rises, and it is possible that the growth in poverty since the late 1980s, took its toll on educational attainment with fewer children being sent to school—see also Chapter 22 on Poverty.

Table 19.6, on the other hand, shows a phenomenal growth in the number of educational institutions at all levels since 1959/60, and a similar trend in the number of students enrolled. Primary schools have increased by nine times in the last 53 years, while primary school enrolment has gone up ten-fold. In the case of professional colleges, while the number of colleges has increased two-and-a-half times, the increase in the number of students has been six-fold. The biggest increase in enrolment is in the universities, where the number of students has increased by thirty-two times since 1959, with a thirty-five-fold increase in the number of universities. Hence, the pattern observable seems to suggest that at all levels, while there has been an increase in the number of institutions, there has been an even greater increase in enrolment. If this is due to the fact that many facilities run more than one school shift, then these ratios show positive trends; if this is not the case, then what is happening is that classrooms and schools are becoming congested, which may be affecting standards.

Government expenditure on education has increased from around 1.4 per cent in the 1970s, to about 2.3 per cent in

Table 19.5
Enrolment and Dropout Rates (%)

		Net Primary Enrolment Rates				Secondary Enrolment Rates		Dropout Rates in Public Sector Primary Schools	
		1991	1997	2002	2012	1995	2001	1996/7	1999/2000
Pakistan	Male	49	46	46	60	35.9	33.1	41	51
	Female	37	37	38	53	19.8	23.3	38	59
Punjab	Male	56	45	47	62	39.5	32.3	41	53
	Female	48	39	43	59	24.2	24.7	38	64
Sindh	Male	43	51	46	57	26.8	30.7	46	53
	Female	33	39	34	48	16.5	25.1	42	47
NWFP	Male	46	42	48	57	41.7	45.2	26	39
	Female	26	32	33	45	11.4	18.1	29	49
Balochistan	Male	39	43	39	56	22.2	19.4	52	49
	Female	20	27	24	35	7.2	12.3	30	41

Source: Social Policy and Development Centre, *The State of Education, Annual Review 2002–03* (Karachi: SPDC, 2003), 9, 14, and 215. For 2011, Social Policy and Development Centre, *Devolution and Social Development: Annual Review* 2011–12 (Karachi: SPDC, 2012), 154.

the 1990s, but fell to below 2 per cent of GDP in each of the three years after 2000 and has remained at that level for many years (Table 19.7). The estimated private consumption expenditure on education between 1985 and 1991 increased at a cumulative rate of 6.9 per cent in real terms, or 3.8 per cent on a per capita basis, and given the rise in private spending, must have increased further since.

However, after the Eighteenth Amendment of 2010, when the responsibility of funding and outcomes was passed on to the provincial governments, one expects that the effort by different provincial governments will result in greater spending on education. Moreover, it cannot be denied that there has been a marked shift in preferences and usage from the public to the private sector, particularly at the primary and secondary levels. It is incorrect to think that it is only the rich and the élite who are consumers of private sector education, for there are hundreds of institutions in the private sector in low-income settlements catering to a large number of consumers. Just as the rich want good education for their children, so do the middle and lower classes. The number of schools may have increased a great deal in the last decades where education has become a highly profitable business catering to diverse needs, however, the absence of quality checks on the delivery and the results, does not allow one to evaluate the nature of the 'education' being imported. It is clear that the numbers of those who enrol and even pass different tiers of schooling are all rising, but whether they are being educated according to any objective criterion, is less certain.

19.3.2 The Issues

Writing in 1984, Viqar Ahmad and Rashid Amjad argued, that

> Before Independence, the main objectives of the education system as designed by the British were to train sufficient numbers of lower level government employees and to shape the mores and attitudes of the future élite by westernizing their cultural pattern. These objectives were well served by separating local-language-medium schools for the masses from exclusive English-medium educational institutions for the élite and by a disproportionate emphasis on a liberal arts education. After Independence, compulsions of economic and social development have changed the pattern of employment opportunities available in the country. The economy's requirements for a large variety of skills and knowledge at various levels are continuously rising. At the same time, attainment of greater equity in income and access to income-earning opportunities are now major social goals.[3]

Although the structure of education, with its clear divide along class and linguistic lines, continues to persist, and in fact is reinforced in contemporary Pakistan, some attempts were made in the 1970s to change the nature and orientation of the education system. In 1972, the Bhutto government nationalized all private schools, prior to which much of the country's secondary and higher level education was in the hands of the private sector, especially in the urban areas. While exact figures do not exist, in 1968 it was estimated that 11 per cent of schools and as many as 35 per cent of colleges were in the private sector. In 1972, the government nationalized 3,067 schools, 155 colleges, and 5 technical institutes. A number of prestigious English-medium schools were exempted from privatization, as were schools owned by missionaries and charitable trusts.[4]

The impact of nationalization was severe, for between 1972 and 1979 the share of private schools fell. In 1976/7, only 1.5 per cent of all schools and 4.1 per cent of the colleges remained in private hands.[5] After the ouster of the Bhutto government, the Zia ul-Haq government reversed the policy of nationalizing schools. In 1979, it once again allowed the private sector to open new schools, and also permitted the

Table 19.6
Number of Educational Institutions and Enrolment by Kind, Level, and Sex: Selected Years

	Institutions														Primary stage (I-V) (000s)		Universities Enrolment	
	Primary schools		Middle schools		High schools		Secondary vocational institutes		Arts and science colleges		Professional colleges		Universities					
	Total	Female	Total	Female	Total	Female	Total	Female	Total	Female	Total	Female	Total		Total	Female	Total	Female
1959/60	17,901	3,260	1,974	281	1,069	203	100	35	126	32	40	5	4		1,890	370	4,092	778
1971/2	45,854	12,290	4,110	1,038	2,247	571	284	134	339	93	73	6	8		4,210	1,110	17,507	3,878
1980/1	59,169	18,595	5,295	1,412	3,479	967	231	88	433	119	99	8	19		5,474	1,782	42,688	7,113
1990/1	114,580	30,422	8,539	3,345	8,011	2,039	725	344	612	218	99	8	22		11,487	3,693	80,354	10,600
2001/2	149,100	55,300	19,100	8,500	12,900	4,700	647	240	925	384	374	19	29		19,521	8,196	117,863	39,682
2011/12	154,600	57,000	42,000	21,000	28,700	11,000							139				131,980	

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

Table 19.7
Expenditure on Education: 1972–2003

Years	Public expenditure (% of GNP)	Household expenditure (% of consumption)
1972–1975	1.4	1.19
1975–1980	1.5	0.92
1980–1985	1.5	1.04
1985–1990	2.3	1.22
1998–2003	1.85	–

Source: Banuri, Tariq et al. 'Human Resources Development', in Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992, 36; for 1998–2003, Centre for Research on Poverty Reduction and Income Distribution (CRPRID), *Pakistan Human Condition Report 2003* (Islamabad: CRPRID, 2003), 197.

denationalization of some of the previously nationalized schools.

At present, while data is hard to come by, it is estimated that perhaps as many as 80 per cent of schools, especially in urban areas, are in the private sector (see Table 19.8). As we keep emphasizing, it is important to point out that the private sector caters not only to the élite or the English-speaking population of Pakistan, but also to the middle and lower middle classes, who appreciate the need for good quality education. Even low income areas and *katchi abadis* in urban areas have a considerable share of private schools, simply because there is a demand for a minimum standard of perceived quality, which most government schools are unable to provide. However, it must also be recognized that not all private schools are of particularly good quality: one report argues that the 'bulk of private schools provide a quality which is only marginally better than the average public school. The major reason for the shortcomings of the majority of the private sector is the lack of any regulations and controls of entry into the sector.'[6] The very poor quality of education in both the private and public sectors has been blamed upon: inappropriate curricula, poor quality of teachers and textbooks, improper teaching methods and techniques, and the absence of a link between market demand and output from the sector.[7]

J. R. Behrman argues that issues of governance, limited accountability and responsiveness to clients, and particularly over-urbanization are key causes of the poor status of the education sector in Pakistan. Moreover, political interference makes matters worse. He writes:

> Anecdotes suggest that there have been serious problems in these dimensions of governance: schooling quality often has been low; primary teacher appointments in a number of cases have been made by provincial Chief Ministers or Secretaries or by Members of Parliament (all of whom have heavy demands on them so this patronage has diverted them from more

Table 19.8
Distribution of Enrolment by School Type (%)

Region	Government	Private
Rural Sindh	96.5	3.5
Rural NWFP	97.4	2.6
Rural Balochistan	89.8	10.2
Rural North Punjab	92.3	7.7
Rural South Punjab	93.1	6.9
Small cities, towns	75.0	25.0
Major cities	57.3	42.7

Source: Behrman, J. R., 'Pakistan: Human Resource Development and Economic Growth in the Next Century', mimeo, 1995, 12.

> important activities as well as having delayed appointments and resulted often in poor fits between the appointments and the positions being filled); teacher absenteeism often has been high in part because of the difficulty of monitoring what is happening in the villages; physical capacities have been underused instead of having multiple shifts; curriculum decisions have been very centralized; centralized payment systems sometimes have had substantial arrears (e.g. reportedly 46,000 teachers in the Punjab recently have had five-month lags in remunerations); 'bricks and mortar' orientation has dominated even though staff and non-salary current expenses often have been the apparent bottlenecks; focus has been on formal public schooling, with little attention and at times disincentives or strong regulations that do not seem related to education (e.g. provincial salary regulations for private schools) for informal education and private education; new girls schools have been delayed in becoming operational because of 'lengthy procedural requirements for sanctioning of new expenditures and teachers' posts'; monitoring and evaluation activities have not been carried out despite commitments to do so. Changes in a number of these dimensions of governance are underway or are being explored in various experiments underway, including some in SAP [Social Action Programme]. For example, reportedly under SAP, at least at the higher levels of the governmental educational hierarchy, some accountability for funds received is replacing the prior sense of entitlement without any need to account for use of resources. But substantial governance problems remain.[8]

Among the most distressing observations from the education sector are the statistics that show the dismal state of education amongst girls and women. There are large gender gaps in schooling, where the primary enrolment rate for girls was 15 per cent below total enrolment rates in 1991, and 8 per cent below the total rates for secondary enrolment. Girls moving from primary to secondary schools in 1987 were 9 per cent less than boys, implying higher drop-out rates for girls.[9] One reason for this has been lower school availability and accessibility for girls. Whether or not a school is available in the same or nearby village is claimed to account for one-third of the large gender gap in schools.[10] While distance to a school may not be critical for boys, for girls, and especially girls in rural areas, it makes a difference whether they attend school or not. Travelling time to school is a significant variable, especially for girls: the longer the time involved, the less likely it is that the girls will attend school.

High drop-out rates are a serious problem affecting the availability of an educated population. Drop-outs take place for a number of reasons: a low overall level of economic development; extensive and widespread poverty; the existence of child labour, which means that the opportunity cost of being in school is high; costly reading material and stationery; poor motivation among parents to retain their children in school; a persistent (albeit declining) negative attitude towards formal education; and a general lack of decent, cheap, and high-quality education.

Many of these issues, such as high drop-out rates, the imbalance between boys' and girls' education, and the poor quality of teachers and schools, exist in other underdeveloped countries. The medium of instruction is also a matter of concern among educationists, planners, and politicians. Should schooling be in English, Urdu, or the mother tongue or home language, and how should the differences be marked? Rashid Amjad and Viqar Ahmad write:

> The existence of élite English-medium schools side by side with national and regional-languages-medium schools also creates equity problems. Since command over the English language is still an asset in getting prized government and non-government jobs, entry to such jobs becomes restricted to those lucky enough to have access to the limited seats in English-medium schools. It is interesting to note that these schools were not nationalized in 1972.[11]

For a country which has been facing a crisis in the education sector, and given the emphasis put on education, discoveries at various times have been made at the presence of schools which exist only on paper and in name, but not on the ground, in reality. While we have discussed issues about the quality of education in Pakistan, the presence of 'ghost schools', puts into some perspective, the problem of education—and of the social sectors, more broadly—into proper context. The problem of ghost schools shows not just official corruption and embezzlement, but also that of NGOs in the business. Clearly the claim that civil society is necessarily better at delivering social services, needs to be tempered and more evidence made available for such clear statements to be made—see Boxes 19.1 and 19.2. Box 19.1 also highlights other aspects of Pakistan's education system, such as the availability of even basic resources necessary to teach children.

Box 19.1

Just How Many Ghost Schools Does Pakistan Have?

These two excerpts from the same newspaper a few weeks apart, signify the problem with data in Pakistan, and highlight the fact that we don't have data about schools, or about many other things, in the country.

1. Khawar Ghuman writes:

The first ever National Education Census (NEC) conducted by the federal education ministry has come up with shocking revelations like the existence of 12,737 ghost schools in the country. Out of 164,579 government schools covered by the census, 6.8 per cent lack buildings, 32.3 per cent are without drinking water, 56.4 per cent without electricity, 40.5 per cent without toilet, and 37.8 per cent without boundary walls.

The findings of the census were shared with journalists by Federal Minister for Education Lt-Gen (retired) Javed Ashraf Qazi on Friday. The total number of educational institutions covered in the NEC was 245,682, 164,579 (67 per cent) in public sector and 81,103 (33 per cent) in private sector. After excluding ghost schools, and those which refused to share the information, the net number of institutions which formed the database of the census is 227,791.

The minister said that some of the 12,737 ghost schools 'exist only on paper, others have buildings but no student or teacher. The largest number of non-functional institutions—7,442 (58.5 per cent)—was found in Sindh, with 4,126 refusing to provide information.

Another finding is that only 1.4 per cent of government schools offer English as medium of instructions; 68.3 per cent follow Urdu as medium of instruction and 22.4 per cent Sindhi medium.

NEC data reveals that out of 26,809 urban blocks, 6,149 have schools and colleges, and out of 50,585 villages, 10,908 have no institution. The overall enrolment in 227,791 institutions is recorded at 33.38 million with the teaching staff of 1.357 million.

Source: Ghumman, Khawar, '12,737 ghost schools in country: census', *Dawn,* 7 October 2006.

2. Bakhtawar Mian writes:

As many as 30,000 ghost schools exist in the country which draw regular funding from the public kitty, says a report prepared by the Consumer Rights Commission of Pakistan.

The report 'Using local government ordinance 2001 to enhance transparency in education' talks of the lacunas in the education sector. It says that due to lack of transparency and public monitoring, use of funds in the sector is not equitable and need-based. Instead, it is mostly politicized, depriving the schools in relatively poor and backward areas of necessary facilities. Today, there are 22,755 schools (16.75 per cent) without shelter, 61,383 (39 per cent) without drinking water, 96,708 (62 per cent) without electricity, 76,312 (49 per cent) institutions without toilet facilities, and 71,681 (46 per cent) schools have no boundary walls, the survey notes.

It targets the whole system and says that the evaluation process is not transparent. In the past, students had been able to pass examinations by giving bribes and managing to get fake degrees and certificates. Administrators and supervisors in districts have become corrupt and found to extort bribes from teachers, students, and parents even for resolving their legitimate concerns. 'The recruitment of teachers and other staff is very often politicised which ends up in recruitment of incompetent and low-quality human resources. Similarly, transfers of teachers are not done on merit and correct need, but on the basis of informal connections and political influence.' Embezzlement of public funds is a major problem, but due to secrecy and lack of public accountability, this corrupt practice could not be rooted out.

As a whole, the survey paints a very disturbing picture of the state of affairs in the education sector, saying it is dismally disheartening, as a non-opaque and cumbersome procedures, formal as well as informal, have allowed the abuse of powers to flourish in this sector. The present procedures and rules do not provide much space for citizens to participate in the relevant planning or to play any significant monitoring role in the sector. As a result, problems of corruption, inefficiencies and irrational allocation of resources pervade this vitally important field. The report stresses on transparency in order to do away with the culture of secrecy in decision-making and actions and enable people to hold the government officials accountable for what they do

Source: Mian, Bakhtawar, '30,000 ghost schools in country: report', *Dawn* 17 April 2006.

19.3.3 Summarizing the Issues in Education

As government facilities have not been able to keep pace with growing demand for educational services, especially at the lower levels, the private sector and non-governmental organizations now play a critical role. Primary and secondary education has now developed into a large business where demand has outstripped supply, hence the increasing role of the private sector. Moreover, as consumers have become more quality conscious, the choice of type of education has burgeoned. The private sector will continue to grow over the next few years. Recognizing this fact, the government should encourage the growth of the private sector, but should also develop checks and balances to ensure an adequate standard of facilities. Some components of the private sector in

Box 19.2

Ghost Schools in Pakistan

In an editorial, *The News* highlighted some of the issues concerning ghost schools in Pakistan.

> If Pakistan had as many schools in reality as it does on paper there would be no crisis in the education sector, and we might be able to fulfil our constitutional commitment to free education for all. From the point of the 1947 Partition, education has never been prioritized and it still is not, with education budgets actually shrinking rather than expanding to match the growth in population. And now we see the return of 'ghost schools' in the context of a federal government education project—the Basic Education Community Schools (BECS). Ghost schools exist on paper and never operate, but they have 'staff' and sometimes buildings. The fictitious 'staff' are paper creatures and only live on a balance sheet, their wages disappearing into an assortment of corrupt pockets. Some 'staff' have fake CNIC numbers. Vehicles have been misused and large sums of money illegally taken from bank accounts associated with the programme. The Planning Commission and the National Education Foundation (NEF) have alleged that there are more than 8,000 ghost schools in the BECS project and they are spread right across the country, including in the federal capital. The project is large, over 8 billion rupees, but funding has now been stopped in the current fiscal year as the irregularities and corruption has come to light.
>
> There is some dispute about the actual number of ghosts in our midst, but no dispute that the BECS programme has serious problems. There are 13,094 schools under the BECS umbrella and more than half may be bogus. The NEF has to outsource administrative checking of schools under BECS to local NGOs, who are themselves a part of the problem rather than part of the solution, as they generated their own administrative costs and were as prone to corruption as any government agency. The thinking behind the BECS scheme was good—small community schools that are home-based serving a minimum of thirty students and with teachers who were matriculate, intermediate or graduate. Some schools have been successful and have students up to class 3, and in general terms the model is satisfactory. But the devil is in the detail, and for the scheme to have achieved its full potential rigorous monitoring was necessary from the outset. It appears that the capacity to monitor adequately was either missing or below par, and the BECS schools are yet another good idea that foundered on the reefs of corruption and ineptitude. Yet again many of the allegations of corruption centre on a political appointee, and the reticence of the National Accountability Bureau (NAB) to pursue the case may well be because of its 'sensitivity' in that powerful members of the ruling PPP would come under scrutiny. There is a genuine and continuing emergency in our education system. Some opine that it is 'too broke to fix' and there is no disagreement that education at every level is in need of a major overhaul. Getting the BECS project back on track would be a significant step in the right direction.

The News, Karachi, 21 July 2012.

education, while fulfilling an urgent need, have compromised on standards, relevance, and quality. The government will have to ensure, through a well-devised monitoring process, that minimal acceptable standards are maintained and enforced. However, this task, while important, cannot be left to the government alone, and the private sector, community groups, and government will need to work jointly towards common goals.

Although the government's role in the provision of educational facilities in the recent past has been eclipsed by the private sector, the government continues to own and run a vast network of schools. The increase in numbers has often meant falling standards and inadequate services provided to users. To ensure better quality from existing resources, local community groups need to be involved in supervising the educational facilities. Participation, even control, by lower tiers of government and concerned actors must also become part of the educational strategy (see Chapter 20).

One area where the government must continue its efforts at an increasing pace is that of girls' education. With very low and inadequate female literacy and school participation rates, the development of facilities for girls cannot be left to the private sector alone. If the government is to undertake one major task in social development over the next few years, it must be the expansion of facilities for girls. This will involve not just opening more schools for girls, but attempts to increase the availability and quality of female teachers will have to be a central piece of any strategy for increasing and improving education for schools. Since the mobility of females is restricted by social norms, potential teachers will have to be found from local communities. If adequate financial incentives are given to train such girls, it is likely that such schemes will be successful. In the informal sector, the phenomenon of home schools should be encouraged. Such schools need funds, guidance, direction and supervision, something which could be provided through Education Foundations and even government support.

Data from studies on education show that the number of primary schools has increased over the last few years, as has enrolment. Quality issues notwithstanding, the government should be complimented for its efforts at increasing these numbers. Perhaps the time now has come to provide for these primary school leavers at the next level. The strategy in the immediate future should shift from an emphasis on primary schooling to one where secondary schools form an increasing component of the education programme. Moreover, there is an urgent need to reform the curriculum in secondary schools and to add subjects with a vocational angle.

However, this line of argument acknowledges the failure and abdication of the public/government schooling system, particularly at the primary and secondary levels. If private schools meet a need, they do so because they are perceived to be better than government schools. If private schools are going to fill the quantity, access and even quality voids which exist, then the larger question about the role of the government in the provision of public goods, arises. If the free market, which is unregulated and profit-oriented, becomes the norm in education, as it is at the lower tiers of education in Pakistan, then the role of government becomes merely to provide poor quality education to those who cannot afford the private sector, i.e. regionally and economically deprived groups. This would further discriminate against the under-privileged groups, regions, and even against girls. Clearly, this is not a preferred option, and there has to be an improvement in the delivery of public sector education in Pakistan. Education cannot be left to the market alone.

19.4 Population Welfare and Family Planning: The Demographic Transition

19.4.1 The Evolution of the Population Welfare Programme

Pakistan, currently with a population of more than 180 million, was the eighth most populous country in the world in 1995, but has now become the sixth most populated country in the world, overtaking Russia and Bangladesh. In the inter-censal period 1981–98, the population growth rate was 2.69 per cent which was amongst the highest in the world. This high growth rate is surprising, considering that before 1950 Pakistan's annual population growth rate was less than 2 per cent. The total fertility rate, 'the average number of children that would be born alive to a women during her lifetime, if she were to bear children at each age in accord with prevailing age-specific fertility rates',[12] fell from between 6.3 and 6.5 in the 1970s, to 6.0 in 1984/5 and 5.4 in 1990/1,[13] falling to 4.77 in 2000 which is still on the high side. Table 19.9 gives some essential indicators regarding the demographic transition of the country.

Pakistan was one of the first countries in the world to initiate a national family and population planning programme, and did so as early as the 1950s. However, it seems that the many population programmes that have been initiated have, until recently, had only a limited impact on fertility, and that Pakistan's success rate has been poor compared with other countries that started later. For the most part, demographic targets have seldom been met, and the lack of political commitment is considered to be a key factor. Added to this has been a lack of funding for the programmes, as well as weak management to oversee and implement them. Moreover, changes in leadership, management, and focus have been frequent, thus failing to give the programmes a secure footing.

Given the changing approaches of the political and technocratic leadership, population policy has also undergone frequent change. In the period 1965–73, the population programme relied 'mainly on the use of traditional midwives (*dais*) to motivate the population, distribute contraceptives, and refer clients for IUD insertions and sterilization'.[14] The Bhutto government in 1973 introduced a novel mechanism called the 'continuous motivation system', which was meant to be implemented by well-trained couples rather than *dais*. The population programme suffered its worst setback in 1977, under the banner of the Islamization programme of General Zia ul-Haq, when it was discontinued for three years. In these three years, no motivational campaigns or field activities were undertaken. After 1985, when democratic forces began to re-emerge and share power in government, the population welfare programmes—essentially a pseudonym for family planning—were once again restarted.

In 1990, with the return to a more meaningful electoral order, and with the lame excuse that 'Islam is against family planning' finally out of the gamut of mainstream politics and out of issues of social development, the population programme was strengthened substantially when a separate Ministry of Population Welfare was created and given the responsibility for all population matters. There was such a sea-change that 'during 1991, government undertook an accelerated program and political support for family planning was now more open. Government programs included steps to expand service delivery and improve efficiency. The number of fixed and mobile sterilization units was expanded.

Table 19.9
Trends in Demographic and Health Indicators: 1965–2002

	1965	1970	1975	1980	1985	1990	2002
Total population (millions)	52.6	60.6	71.0	82.6	96.2	112.4	146
Population growth rate (%)	2.7	3.0	3.1	3.0	3.1	3.1	2.69
Crude birth rate (per thousand)	48.0	47.6	47.4	47.1	45.1	41.6	30
Crude death rate (per thousand)	20.9	19.1	16.9	14.7	13.1	11.9	8
Total fertility rate (birth per woman)	7.0	7.0	7.0	7.0	6.5	5.8	4.77
Contraceptive prevalence rate (% of females 15–49)	n.a.	n.a.	11.0	5.0	9.1	10.7	27.6

Source: World Bank, *Staff Appraisal Report: Pakistan Population Welfare Program*, Report No. 13611-Pak (Washington DC: World Bank, 1995), 56; for 2002, Government of Pakistan/UNFPA, *Pakistan Population Assessment 2003* (Islamabad: GOP/UNFPA, 2003).

Population education programs were enlarged and targeted better. Field supervision was strengthened and community involvement was sought.'[15]

Because the focus of the population planning organizations in the past had been primarily on the supply of contraceptives irrespective of the demand for these products, the impact on fertility was low, and the population growth rate remained high. By the time the Seventh Five-Year Plan was launched in 1988, a multi-sector population programme approach had been devised, consisting of three major components:

i) establishment of Family Welfare Centres to provide family planning services jointly with mother–child health care, motivation/education and community development activities;
ii) provision of gynaecological and obstetric services and contraceptive surgery through reproductive health service centres established in government and private sector hospitals; and
iii) implementation of a Major Information, Education and Communication Program, which through mass media, personal and group communication promotes breastfeeding, maternal, and child care practices, nutrition of the growing child, responsible upbringing of the child, late marriages and the status of women.[16]

Just as the philosophy and emphasis have changed, so has the amount of funds allocated to population welfare projects. During the 1980s, expenditure on the population sector averaged 0.06 per cent of GNP and never exceeded 0.07 per cent. As a share of total public expenditure, expenditure on population averaged 0.24 per cent during 1983–92, which was less than 10 per cent of the total expenditure on health.[17] This, by any stretch of the imagination, is on the very low side. As a World Bank report on population planning in Pakistan concluded, 'chronic underfunding of the population program has constrained its prospects for expanding outreach and improving service delivery'.[18]

With the change in emphasis prior to the Seventh Five-Year Plan, the government was, for once, willing to put its money into an area that it felt needed priority. The actual expenditure on the population sector during the Seventh Plan actually exceeded the Plan allocations, reflecting the renewed and growing priority given to the population sector. The Eighth Five-Year Plan placed an even stronger emphasis on the government's population programme, aiming to spend 0.15 per cent of GNP between 1995/6 and 1997/8. Although a small figure in absolute terms, this is, nevertheless, double what the government had spent of late and was three times the amount allocated under the Seventh Plan.[19] The World Bank has observed that 'over the last few years, a consensus has been growing in Pakistan on the need to address the population issue seriously'.[20] While discussing the funding aspects of the population programme, it is also important to emphasize that a large amount of the funds have often come from abroad as foreign aid, a component that has varied considerably. Foreign aid contributed 19 per cent of funding to the population programme during the Fifth Five-Year Plan (1978–83), rising to 53 per cent during the Sixth Plan when the government itself cut its own initiative, and was 40 per cent of the allocation in the Seventh Five-Year Plan (1988–93). The main source of funding was USAID, which provided as much as 87 per cent of total assistance during the Seventh Five-Year Plan. After the departure of USAID from Pakistan in 1993, foreign assistance covered about 25 per cent of the population programme expenditure, which remained about the same over the 1993–2004 period, showing that the government is the main player in the provision of contraceptives. Since 1993, social marketing organizations which promote and advertise contraceptives, and have large amounts of donor funding, have played a major role in popularising and making available, different types of contraceptives. Donor funds in the population sector increased from $15.5 million in 1990, to $28 million in 1999.[21]

In recent years, and especially after devolution under the Eighteenth Amendment, there does not seem to be a concerted programme to address population planning by the government. NGOs and the heavily subsidized private sector now take the lead in providing facilities for family planning. This is even though Pakistan's contraceptive usage rate in 2011 was only 27 per cent, while Sri Lanka's and India's was 68 and 56 per cent, respectively. Both Iran and Turkey have a contraceptive usage rate of 73 per cent, and most Muslim countries have a higher contraceptive usage rate than Pakistan's very low rate. This may also explain the fact that Pakistan has one of the highest population growth rates in the world, of 2.03, compared to 1.3 in India, 0.8 in Sri Lanka, and 1.0 in Malaysia and Iran, all countries having considerably higher contraception prevalence rates.

19.4.2 Knowledge and Usage

A 1995 World Bank report on population in Pakistan argues that 'taken altogether, all of Pakistan's family planning effects make services available to less than a quarter of the population. The Ministry of Population Welfare covers about 10–12 per cent of the population and other organizations another 13–15 per cent. *Such low coverage is partly responsible for the low contraceptive use.* The number of clients per facility, however, varies widely across and within provinces and between urban and rural areas.'[22] Although these numbers may have improved, as we show above, they are still far worse than comparable countries. According to the estimates of the Ministry of Population Welfare, the coverage is about 54 per cent in urban areas, while it is only 5 per cent in rural areas. Although some facilities do exist, they are widely spread and most offer very limited services. It has been calculated that the average walking distance to a Family Welfare Clinic in the Punjab is about 9.3 km, while it is more than 100 km in parts of Balochistan where, for all practical purposes, supply seems quite restricted, especially since visits to the clinics involve considerable time and travel costs. Evidence shows that few clients, rural or urban, are willing to travel more than 5 km to a clinic and very few actual users travel more than 10 km. In Pakistan, 'in both rural and urban areas, awareness and use of Family Welfare Clinics declines sharply with increasing distance from a Family Welfare Clinic'.[23] However, increased donor presence and NGOs have made access and

supply much easier, and NGOs have played a major role in supplying contraceptives. However, the government is the most important source for supply of contraceptives, and until government outreach increases and improves, the choice and use for family planning will be limited.

Evidence about knowledge and use of family planning techniques in Pakistan has shown that a very high percentage of married urban women (97 per cent), and an impressive 94 per cent of rural women are aware of some form of modern birth control (Table 19.10). Education plays an important role: as the level of education among women increases, so does their knowledge about contraception. This is hardly a surprising result, since it is likely that women with more education have greater access to the media, which is a major source of information on family planning, and have access to a wider social network in which information about family planning is likely to be available. Moreover, since better-educated women are likely to marry better-educated men as well, there are possibilities of more information being available. One of the more surprising results from a large survey conducted in Pakistan was that it was the NWFP, rather than Punjab as one would have expected, where the largest number of married women were aware of modern contraceptive methods: 83.3 per cent of married women in NWFP knew about contraceptives, compared with 79.9 per cent in the Punjab, 73.9 per cent in Sindh, and 36.5 per cent in Balochistan.[24] However, despite this knowledge, the usage—Contraceptive Prevalence Rate—is still only 27 per cent, and has not improved in over a decade, which in India is 56 per cent and in Bangladesh an impressive 58 per cent. It is worth noting that Bangladesh had a annual population growth rate of 2.3 per cent in the 1970–90 decades. This has now fallen to only 1 per cent.

The total fertility rate (TFR), which has fallen over the last few decades, depends upon: the incidence of marriage, the age at marriage, the practice of breastfeeding, use of contraception, and a number of socioeconomic variables, especially those affecting women, such as female education, female labour force participation, and the infant mortality rate. Poverty, illiteracy, and women's low status in society all combine to sustain the high levels of population growth in Pakistan. Moreover, features such as location of residence—urban, large city, small town, rural, etc.—also affect the TFR (see Table 19.11). There is a marked fall in the TFR in large cities compared with the rural areas. Similarly, there is an even more appreciable decline when one considers levels of education: with no education, the total fertility rate is 5.7 and higher than the overall average of 5.4, while for those women who have secondary education, the total fertility rate falls sharply to only 3.6. *Education*, it emerges, in study after study, *is the single most critical determinant of most key social sector indicators, especially fertility related issues*—see Chapter 20 on women for further discussion.

19.4.3 Some Issues

Delivery and Quality

The quality of services available for family planning is considered to be uneven, and often inadequate. Many Family Welfare Clinics, like much of the public sector, work intermittently, are frequently closed, and have staff that are often absent or inadequately trained. A study found that about one-fifth 'of these centres lacked examination facilities, and many did not offer adequate privacy in examination and counselling areas'.[25] It is not surprising, then, that the poor quality of service in government clinics deters and discourages users. This is despite the fact that the demand for family planning services in the country is quite high and continues to go unmet. In rural areas where only 5 per cent of married women had access to family planning services, virtually no outreach had been provided for women who may want to use family planning services and who 'have to cover too great a cultural and physical distance to obtain them'.[26]

Table 19.10
Fertility Rates and Contraceptive Knowledge, Attitude, and Practice

	Total fertility rate 15–49		Knowledge of modern contraception (%)		Both husband and wife approve (%)	Current use of any method (%)	
	1995	2000	1995	2000		1995	2000
Residence							
Urban	4.9	3.67	91	97.3	53	26	39.7
Rural	5.6	5.40	71	93.9	24	6	21.7
Education							
None	5.7		73		27	8	
Primary	4.9		92		43	18	
Secondary	3.6		95		70	38	
Overall	5.4		77		34	12	

Source: World Bank, *Staff Appraisal Report: Pakistan Population Welfare Program*, Report No. 13611-Pak (Washington DC: World Bank, 1995), 33; for 2000, Government of Pakistan/UNFPA, *Pakistan Population Assessment 2003* (Islamabad: GOP/UNFPA, 2003).

Table 19.11
Fertility by Background Characteristics

Background characteristics	Total fertility rate	Mean no. of CEB (women 40–49)
Residence		
Total urban	4.9	6.3
Major city	4.7	6.3
Other urban	5.2	6.4
Rural	5.6	6.4
Province		
Punjab	5.4	6.3
Sindh	5.1	6.6
Karachi	5.0	7.1
NWFP	5.5	6.1
Balochistan	5.8	5.7
Education level attended		
No education	5.7	6.5
Primary	4.9	6.1
Middle	4.5	5.3
Secondary	3.6	4.3
Total	5.4	6.4

CEB = Children ever born.
Source: NIPS, *Pakistan Demographic and Health Survey, 1990/1991*, Islamabad, 1992, 41.

Economic Factors and Fewer Children

Much of the discussion in the earlier sections have focused on the technical aspects of family planning—the number of facilities, the demand for services, etc. One of the most important determinants of having fewer children is the household's economic constraints. It is becoming increasingly difficult to afford large families nowadays, where the quality of human resources matters just as much as the quantity. Many families are forced to opt for a smaller family due to economic constraints, which also effect larger families as well. In addition, as much of the available information and data suggest, that more education results in lower fertility rates and a greater use of birth control methods. Greater migration to urban areas is another factor that results in smaller families, essentially because in larger cities, given the problems with employment, housing, and access to services, it is not economically viable to have large families.

The status of women—their education, labour force participation, etc.—is a critical factor that also affects family planning. As we argue in Chapter 20, the status of women is also linked to economic development. Hence, as growth or development takes place, women's contribution to the economy increases and their status improves, with the likely result of a fall in the population growth rate.

While cultural and social factors are also influenced by economic and social development, most changes in the population growth rate will come about once individuals and households recognize, or are forced to accept, the need for smaller families, essentially on economic grounds. Smaller families mean better-educated and healthier families, and for most people, given the increasing cost of living, there may be few choices regarding family size. In such circumstances, the role of family planning should be to improve the provision of information and the supply of services and facilities. The evidence suggests that there is growing knowledge and awareness of family planning techniques and a recognition of the need for such services. What is lacking is adequate supply.

19.4.4 Pakistan's Demography: Dividend or Disaster?

Optimistic views about Pakistan's place in the world, often those of the government in power, package and spin Pakistan's population and demographic transition in highly favourable terms. Statistics are marshalled which show that Pakistan has the world's sixth largest population, according to unconfirmed and uncontested figures has the seventh largest diaspora as well as the ninth largest labour force. An assumption is made, based on the fact that the developed countries have rapidly declining fertility and aging populations, that Pakistan's so-called, growing 'talent pool' might be able to play a bigger role to satisfy global demand for workers in the twenty-first century and contribute to the well-being of Pakistan as well as other parts of the world. There are huge assumptions made in such optimistic scenarios and often hard realities affecting Pakistan's economy, are overlooked.

Pakistan's Crude Birth Rate (CBR) peaked at about 45 in the late 1970s to early 1980s, around the time when the demographic transition took off and decreased to 30 births per 1000 population by the year 2006. By 2050 it is expected to almost halve, at 16 births per 1000 population The Crude Death Rate (CDR) in Pakistan declined from 24 deaths per 1000 population in 1950 to approximately eight in the year 2006. It is expected to continue to decline before increasing again, after the year 2045. This increase would be due to the changing age structure of the population, which would then have a bigger proportion of the elderly. The population growth rate was highest in the 1980s, according to some estimates around 3.5 per cent per annum. This rate began to decline after the mid-1980s, reaching a rate of two per cent per annum by the year 2006. It is estimated to be around 1.8 per cent presently—the Government of Pakistan statistics state that it is 2.03 per cent. Low and high variants of population growth rates by the year 2050 show figures in the range of 1.26 and 0.25, respectively, as the fertility rate also falls. The dependency ratio has also declined from 0.86 to 0.75 over the last two decades.

Demographers looking at the age structure of Pakistan and the possible dividend which it might bring about, have suggested that this dividend exists in the period 1990–2045, after which the opportunity to capitalize on the young age structure will be lost. Economists believe that there is a three to four decade window available—with two decades already lost—for providing employment to, and increasing the productivity of, the rapidly growing labour force, in order to improve and increase growth in the economy.

Pakistan's demographic transition projects a young population, all in an age bracket which ought to promise a gainfully employed, and increasingly skilled, population

for some decades to come. With around 50 per cent of the population below 20 years of age and 60 per cent below 30, its workforce is growing at a faster rate than the total population. Pakistan's population is projected to reach a staggering 350 million by 2050, almost double its present size, with the age structure showing a share to be occupied by the working age group progressively increasing. The urgent need to capitalize on this transition will affect Pakistan's future.

Estimates and calculations suggest that within the labour force, the number of persons in the young age group (between 15 to 49 years) is projected to double from 96 million in the year 2010 to 181 million in 2050. At the same time, the total labour force is projected to increase from 110 million currently, to an estimated 235 million in 2050. Various estimates indicate that around 3.1 million persons, out of which as many as 2.1 million are young, will enter the labour force annually, and will continue to do so till 2050. Three million jobs will need to be created every year to incorporate the main component of the demographic dividend. Given existing trends in the economy, can one make capital from this available labour power?

Between 2008–13, Pakistan's GDP growth rate has been around 3 per cent, and while it has had a five per cent plus record over the last five decades, recent trend averages suggest a lowering growth rate trend. Government figures give an unemployment figure of 5.6 per cent, a figure which has not been found to be credible and has varied little even when the GDP growth rate fell to 1.7 per cent in 2008/09. In fact, the unemployment rate claimed by the government, was the lowest since 1999, in 2008/09, when the economy grew by the slowest rate in more than two decades, giving an indication of the reliability of the statistics. The presence of a large—perhaps as large as the size of the economy—undocumented and informal economy, does mean that actual unemployment figures are hidden. Moreover, the phenomenon of disguised unemployment, common not just in the agricultural sector which employs around 45 per cent of the labour force, is also manifest in the services sector, where jobs are created to accommodate a growing population, compromising low productivity and output.

While economic growth and investment are the keys to accommodating the growing labour force, Pakistan's real investment rate has fallen from 13.1 per cent of GDP in 2010/11 to an even lower 12.5 per cent in 2011/12. Clearly, economic signs to absorb the youth bulge do not, for the present, look very optimistic. Not only does the GDP growth rate need to rise to above 6 per cent to deal with the 33 per cent below the poverty line, but the growth strategy has to be one which is not just of inclusive growth, but also actively creates jobs for the existing and new entrants in the workforce, and will have to have a high employment elasticity to rapidly absorb those who need work. A jobless growth phenomenon, prevalent in some countries over the last decade, will not work for Pakistan's rising young labour force.

This dire analysis leads to the discussion about the quality of growth in Pakistan, and that of education and skill formation in the country. While the literacy rate and education enrolment rates have been rising, with a growing middle class conscious of the gains from higher education, skill shortages are not uncommon in Pakistan. Moreover, with growth being depressed and slow, a young and mobile member entering the workforce, particularly one who is skilled, will seek any form of employment anywhere. This is likely to create a further brain drain on Pakistan's economy, since those who can migrate—the high-skilled job seekers—will do so. With other factors, such as political instability and the precarious law and order situation, the attraction for young Pakistanis to stay on and work in the country works against keeping the better-skilled population in Pakistan.

While the quality of education is a varied mix, in the rising urban middle class, there is a substantial and growing demand in Pakistan from students, parents, and employers, for private quality higher education along with a willingness and capacity to pay relatively high tuition fees. There has been a boom in private institutions seeking affiliations with foreign universities to ensure they offer information and training that is of international standards. Some data suggests that there may be around 40 programmes running in affiliation with British universities at undergraduate and graduate level in the private sector in Pakistan, with the UK providing the large part of this market. Quality education is a high growth area in Pakistan, and the active recruitment of Pakistani students in foreign universities, as visible through the large number of advertisements in newspapers, is indicative of this trend. Numbers of how many students avail of these opportunities are difficult to acquire, and it is even more difficult to assess how many Pakistani students fail to return to Pakistan.

Although Pakistan has been at the forefront of the War on Terror, and while fundamentalism and militancy have increased, it would be simplistic to equate the absence of job prospects in the youth with growing Talibanization and militancy. Nevertheless, it cannot be ignored that unemployment and the dwindling of opportunities and faith in the future, despite the recognized 'Pakistani resilience', do have repercussions which have a destabilizing effect on society. By all accounts, unless a growth strategy which focuses on creating employment is put in place, *Pakistan's hopeful demographic dividend will became a demographic nightmare.*

A British Council report, *Pakistan—the Next Generation*, looking at Pakistan's demographic transition recently, saw Pakistan facing a 'frightening' demographic disaster, with young people 'deeply frustrated, profoundly religious and having little faith in democracy', warning of a demographic disaster in the making. Although there is no prediction about Pakistan becoming a failed state with young militants ruling the roost, the destabilizing political and ideological factors in the region could add fuel to a possible fire. While the absence of economic opportunities and prospects is worrisome, it need not give rise to a sense of panic, at least, for the moment.

19.5 Urbanization and Housing

19.5.1 The Extent of Urbanization

There has been a considerable growth in the urban population of the country over the last six decades. In 1951, when the first census was held, only 17.6 per cent of Pakistan's population lived in urban areas; by 1981, this had increased to 28.3 per cent and according to the last census of 1998, was 32.5 per cent, although this figure has been disputed by numerous people for it tends to under-report an accurate figure—see Appendix 19.2. In fact, an underlying theme in this book, which has a bearing on much contemporary political economy, is that Pakistan is predominantly urban now, a fact which has numerous repercussions on politics, social change, and on the economy of Pakistan—see Box 19.3 which looks at urban Punjab.

Urban population growth results mainly from three factors. Firstly, there is the 'natural' population increase, which is the growth in urban families themselves; secondly, urban areas expand and grow as areas previously considered rural are transformed into urban areas, and thirdly, there is net rural to urban migration, adding to the existing numbers of residents in towns and cities.

Rural areas become urban as areas adjacent to urban centres, over a period of time, assume urban characteristics: '(i) as a result of the overspill of urban activities and increases in population density resulting from natural population growth and migrants settling in these peri-urban areas; and (ii) the growth of small rural centres which through increases in population density and broadening of functions gradually assume more urban characteristics, allowing them to be reclassified as urban over time'.[27] This last point is essentially an administrative criterion that 'creates' urbanization—see Appendix 19.2—Reza Ali on the phenomenon of the urban-rural divide.

The urban sector has grown considerably since 1981, and the growth and dynamism in urban population and of the urban economy was substantial in the 1980s compared with the relative stagnation of the 1970s. By the administrative criterion alone, between 1983 and 1991, 114 additional rural settlements became urban as their population increased and they acquired the status of Town Committees. This growth can be contrasted with that of the period 1972–81, when only 24 new administrative urban areas were created.

In the period 1972–81, the urban population growth rate was 4.4 per cent per annum, which had increased to a growth rate of 4.8 per cent per annum between 1981 and 1993. Interestingly, the urban population growth rate had been declining in the inter-censal periods between 1951 and 1981, and the rise since 1981 is distinguished by being against the trend. The reasons for this are discussed later in this section.

Between 1972 and 1981, inter-censal urban population growth rate was 4.4 per cent per annum, the contribution of rural transformation to annual urban population growth was about 8 per cent, while during 1981–92, about one-third of urban population growth was attributed to rural–urban migration and spatial amalgamation.[28]

The provincial urban population growth rates in Table 19.12 reveal that the Punjab had the fastest growth of 4.9 per cent between 1981 and 1993, while Sindh and Balochistan grew fastest in the 1970s. By 1993, about half the population of Sindh lived in areas designated as urban, while 35 per cent of the Punjab and 18 per cent each of Balochistan and the NWFP were considered urban populations. Some 56 per cent of the entire urban population of Pakistan lived in the Punjab, 34 per cent in Sindh, 7 per cent in the NWFP, and 3 per cent in Balochistan. The rise in the urban population during the 1980s also meant that five more cities—Gunjranwala, Multan, Rawalpindi, Peshawar, and Hyderabad—joined Karachi, Lahore, and Faisalabad in the group of cities with more than one million inhabitants. (See Appendix 16.2 in the first (1999) edition of this book, on the problems of urban growth in Gunjranwala.)

Urban growth and particularly rural–urban migration are normally attributed to push and pull factors. Push factors are those which cause inhabitants to leave the rural areas, such as declining agricultural growth and production, tractorization causing the displacement and eviction of farmers, and floods and natural calamities. The lure to urban areas depends on the availability of jobs in industry and services, the desire for better schooling and health facilities, aspirations to an urban culture, and the 'bright lights' phenomenon.

In the 1980s in Pakistan, some of the reasons listed above had an important effect on the 4.8 per cent urban growth, most of which was due to rural immigration. Food production did not grow significantly in the 1980s, and the more than 3 per cent population increase in rural areas was now facing slower output growth. There has been increasing fragmentation of land holdings as the population has grown, and mechanization has also affected rural migrants, displacing them from agricultural land. In the cities, the 1980s were a boom period, with a growing and dynamic manufacturing sector, with the construction and service industries also showing very positive trends. Not only is migration affected by actual conditions, but even perceived and expected conditions may cause migration to grow. For instance, for each individual who actually finds an urban

Table 19.12
Urban Population by Province (%)

	1972	1981	1998	1998 adjusted[1]
Pakistan	25.4	28.3	32.5	36.2
Punjab	24.4	27.6	31.3	34.5
Sindh	40.4	43.3	48.8	51.6
NWFP	14.3	15.0	16.9	25.4
Balochistan	16.4	15.6	23.9	26.7

Note: (1) the '1998-adjusted' includes 361 rural areas with more than 5000 inhabitants having urban-related characteristics—see also Appendix 17.3.

Source: Data for 1972, 1981, 1998 from Population Census Organization, Census Reports. For 1998 adjusted, Arif, G.M., 'Urbanization in Pakistan: Trends, Growth and Evaluation of the 1998 Census', in Kemal, A. R et al. (editors), *Population of Pakistan: An Analysis of Population and Housing* (Islamabad: PIDE, 2003).

Box 19.3

Changing Urban Punjab

Umair Javed discusses issues related to Punjab's urbanization and to the rise of its middle classes.

Liaquatpur is a settlement of approximately 40,000 people, located half an hour away from Rahim Yar Khan city. The town's economy is largely dependent on the retail/wholesale sector, and on transport and storage businesses, which in turn, are closely linked to its main produce market. The town center houses a public sector degree college, three private commerce and information technology colleges, an English language training center, at least 2 gyms (for men), 3 beauty parlors, 1 snooker club, and what appears to be the indigenous version of a popular fast food chain. All of this, obviously, is over and above the countless number of grocery and produce retailers, mobile phone vendors, arhtis, and cloth merchants.

Based on what little of Punjab I've seen, there is nothing about Liaquatpur which distinguishes it from countless other settlements located all over the province. Take a trip from Rawalpindi to Lahore on the N-5 and you'll encounter Liaquatpurs of varying shapes and sizes after every 15 minutes. Turn west towards Sargodha, and the landscape might change, the dialect certainly becomes harsher, but the small town with its garish IT institute and commerce college billboards maintains a ubiquitous presence. So much so, that a friend of mine who once left Lahore, for a weeklong trip to discover the idyllic, untouched, and mostly imaginary plains of rural Punjab, came back thoroughly disappointed.

On paper, Punjab's urbanization stands at approximately 30 per cent, which basically means that 3 out of every 10 people live in areas that folks at the statistics bureau classify as urban. This figure, according to urbanization experts like Reza Ali, is grossly underestimated thanks in part to the continued usage of outdated definitions and partly due to a seemingly infinite inter-censal period. Hard distinctions, (never easy to develop), are now impossible to create as countless rural union councils (and there are around 2,486 of them) have developed urban pockets over the last 15 years, and now stand contiguous with those classified as completely urban (978 by the end of last year). What's harder to capture, and infinitely more interesting, is how the ethos of the province has changed from peasant proprietor haven under the Raj—(the Punjabi peasant is a hardworking, content subject who wants nothing more than an acre of land and a fresh stream of water)—to an upwardly mobile, rabidly consumerist market in more contemporary times.

To account for more qualitative changes, it's easy to divide them into two distinct (but not mutually exclusive) categories. On one side, lies the development of new sub-cultures in rural, peri-urban, and urban areas. Changing dietary preferences, and an association with what are perceived to be 'urban' trends like western dressing, mobile communication, and even educational choices, mark recent investment in towns across Punjab. Only a week ago, a popular domestic fast-food chain based out of Lahore advertised franchise opportunities in 26 locations across Punjab. Most of these locations, like Chichawatni, Kharian, Wazirabad, Jauharabad, and Sadiqabad, are those that have seen mini population booms in the last two decades. Similarly, private colleges guaranteeing 'market-based' education in the English language (for a reasonable fee) are now seen as functional alternatives to the less expensive, but more competitive public sector institutes. Mian Amir's Punjab Group of Colleges, with campuses in 13 districts for example, is one such flagship example.

20 years ago, the thought of a shawarma outlet, or a shopping mall, or even an IT college in some of these locations would've seemed preposterous. In 2012 however, these ideas are not only relevant, but businessmen are busy making millions off this new consumerist ethos.

The other category of qualitative transformation has been in the political sphere—specifically in terms of how people vote (patronage based or autonomous), the relevance of primordial identity (clan, ethnicity, language), and the emergence of new political actors. Like the Janus-faced nature of capitalistic development elsewhere in the third world, the vibrant consumerism of Punjab's new middle class hides a number of more sinister changes. For starters, the linearity of modernization theory, which posits a change from traditional social organization to more individualized existence, has failed to materialize in any meaningful way, except maybe in some suburban parts of the biggest cities. In a bargain between the new and the old, hybrid forms of social organization and interaction have emerged that use both economic and cultural means to form patronage networks. One such manifestation of this trend has been in the vastly informal sector of secondary manufacturing and retail in Punjab, which relies on the fragmentation, co-option and oppression of labour through a variety of economic and cultural means. Labour agents, colloquially referred to as jobbers, use a variety of biraderi and clan-based ties to market and sell off unemployed, unskilled workers to small-scale manufacturing concerns, and in some cases, to employers in the Gulf.

It is these small-scale businessmen, traders, transporters, and retailers that have emerged as a political force over the last 30 years—both as the backbone of the PML-N and as an independent 'civil society' formation. Collective groups like the All Pakistan Anjuman-i-Tajiran (APAT) and All Punjab Transporters Association (APTA) have exerted their political influence on policy-making—most recently exemplified in their successful efforts to remove Form D from the Income Tax return document.

But perhaps nothing gives a better indication of the mix of cultural, political and economic changes than the entrenchment of religious groups and movements throughout the province. Whether it's the popularity of the Al-Huda movement within upper-middle class females of Lahore and Rawalpindi, or the more class-cutting, revivalist appeal of the TableeghiJamaat, or even the militant interpretations of fundamentalist organizations, Islam has formed an almost organic relationship with the process of transformation. Trader groups patronize religious organizations in return for both divine favour, and worldly assistance during elections and public demonstrations. In parts of South Punjab, the

Sipah e Sahaba Pakistan (SSP) cadre has found common cause with elements within the Seraiki province movement, using religious and linguistic denomination as another wedge in a society already divided along socio-economic and native (muqami)-settler (abadkar) lines.

Enhanced mobility, communication, and outreach—all of which are characteristics of rapid urbanization—serve as catalysts in exacerbating socio-economic, religious, and cultural differences. While Punjab's emerging middle class boom remains a fascinating phenomenon, it is worth noting that it masks a number of deeper, structural problems—such as ethno-linguistic tensions, militant fundamentalism, and labour oppression. It remains to be seen whether a corrective form of politics can emerge within the province, which ultimately seeks to counter the more worrying aspects of its transformation.

Javed, Umair, 'Urbanization and its Discontents', *The Friday Times*, Lahore, 15–21 June 2012.

sector job, many more wait in line and follow him, hoping to find a job at a later date. Although figures are not readily available, urban unemployment is still not at the critical stage where migration from rural areas would cease. As long as there is a belief that better jobs can be found in cities, rural–urban migration will continue.

It is not just the very large cities that have grown over the last decade; the most dynamic have been the intermediate cities, especially in the Punjab. As in the 1960s following the Green Revolution, so in the 1980s, due to linkages with the agricultural hinterland, but particularly due to remittances received from the Middle East, investment in industry, construction, and services has been noticeable in the smaller towns and intermediate cities. It is inevitable that the growth of cities will continue in Pakistan for many years to come, and the majority of the country's population already live in areas designated as urban.

19.5.2 Rethinking Urban and Rural

While these trends suggest how and why urban spaces—cities—have grown at the expense of the rural areas, a larger question which needs to be addressed is whether there is anymore an urban-rural divide in Pakistan? Can one bifurcate large areas of Pakistan—with the possible exception of Balochistan—and call these areas 'rural'? Is there not, as Reza Ali has argued so clearly in Appendix 19.2, a continuum of cities into rural areas, diminishing any hard classification between urban and rural? More importantly, what does one mean by the term 'urban' or 'rural'? Is this related simply to agricultural production compared to non-agricultural economic activity? If this were a working definition, as we have argued in the Section on Agriculture in Chapter 5, much of the so-called rural areas constitute a large, if not dominant, share of non-agricultural employment. Moreover, the services which were considered 'urban' some decades ago—such as electricity, education, television, communications, transport, etc.—are now also visible in 'rural' areas. The fact that one million mobile phones are added on each month in Pakistan, must mean that even in so called 'rural' areas mobile phones are being purchased and as such technology is available. Clearly, it is important to rethink such categories as 'urban' and 'rural', and understand why we need such binaries. Perhaps other ways of looking at well-worn concepts might help us in understanding issues and those concepts much better.

The continuing meticulous work of Reza Ali, examining the spatial and geographical spread of Pakistan, questions the nature of 'urban' and 'rural', in the Pakistani context, well beyond his path-breaking 'Underestimating Urbanization?',[29] and has led to a further, more recent, interpretation of the nature of 'urban' in Pakistan.[30] He shows, that the difference between urban/rural is largely a matter of definition, and many ad hoc definitions are used for a variety of purposes, which are often inconsistent, non-comparable, and incomplete. Census officers, for census purposes usually define what is 'urban' or metropolitan, with the 'residual' assumed to be rural; governments, for policy and interventions use definitions such as 'urban and 'rural' in Sindh for job quotas to bring equity in government employment.

Since census taking began in British India in 1861, urban population meant the *de facto* population of cities and towns. Cities and towns included: (i) every municipality; (ii) all Civil Lines not included in municipal limits; (iii) every Cantonment; and (iv) every other continuous collection of houses inhabited by not less than 5,000 persons, which the Provincial Superintendent may decide to treat as town for census purposes. The essential difference between a rural and urban population was that the former was mainly engaged in agriculture and the latter in commerce, manufactures and other occupations. Thus a place having a population of 5,000 or more would be considered a village if it did not possess urban characteristics. The 1981 census changed the definition to an administrative criterion—that of status of local government, thus the population living within the boundaries of all 'urban local councils' was designated as 'urban'. This 1981 definition based on 'administrative definition', implied, that all places which would earlier have qualified as urban, would have been ignored, such that, in the 1951 census, of 235 urban places, 121 (51.5 per cent) did not have administrative status; in the 1961 census, of 336 urban places, 219 (65.2 per cent) did not have administrative status. By only considering administrative status in 1981, 72 urban places in 1972 were considered rural in 1981, and in 1972 the urban population of 1.356 million living in these 72 urban places was declared rural in 1981, thus not considering 5.7 per cent of the urban population. Other estimates, such as those conducted by Pakistan Institute for Development Economics (PIDE) for the 1998 census calculated, that 361 places were considered rural in the census which had a population of 5,000 or more and *actually had urban characteristics better than many places considered*

urban in the census; if their population is considered urban, the PIDE study estimates this would add another 6 per cent to the urban population.

This definition of administrative boundary also had other obvious repercussions. City expansion is rapid while boundary revisions are infrequent, thus all new suburbs and peripheral growth is outside the boundary. In the 1998 census, Lahore's Defence Housing Authority (DHA), Lahore Development Authority (LDA) and other private schemes, were rural. By just considering the population within the administrative boundary of Lahore as urban, the sub-urban and peripheral population outside the boundary was considered rural. Not surprisingly, the municipality population grew at 3.14 per cent p.a. while the surrounding 'rural' areas at 4.14 per cent p.a.

Clearly, definitions matter. On the one hand, 'rural' and 'urban' seem clear terms with contrasting images: isolated farms, tiny hamlets, cultivated fields, and villages, *versus*, the thriving city, its skyscrapers, and slums. This may have been a simple way of defining 'urban' and rural' some centuries or even decades ago, but this dichotomy is comfortable but imprecise, and over-simplified. Life changes in a variety of dimensions along this route: from fields and intensive cultivation, villages and small market towns, to larger towns, small cities and the cosmopolitan city. It is not a single homogenous activity—it is multi-functional and diverse. *Categorizations are largely becoming irrelevant as people live their lives in different ways rendering conventional definitions obsolete. The urban/rural divide appears as a gradient, rather than a dichotomy.* There does not appear to be a natural dividing line or break point between rural and urban areas. Many social, cultural, economic and environmental issues are inadequately addressed by current approaches separating 'rural' and 'urban'. Behaviour and conditions change drastically along the gradient, but there seems no compelling reason to segment this into just *these two* categories

The key features of the urban context have been defined as proximity, density, diversity, dynamics and complexity. Two factors that stand out are population density, and an urban core and proximity to the city. These can be said to be key indicators of agglomeration economies and rent.

(a) Population Density

Population density is an important criterion for economic behaviour—to have a thick market, there must be a certain mass of people. Density is a proxy for market thickness. Dense proximity of a diverse pool of skills provides agglomeration benefits: drives agglomeration economies that are a defining feature of cities—transport, infrastructure, amenities also bear on these economies, affects unit cost of investment—fixed facility costs or higher mean travel cost to facility. Low density areas may be too small to support competition in product and service markets, leading to capture by local monopolies.

(b) Urban Core and Proximity—distance to city

The existence of an urban core and its proximity (or distance) captures important determinants of economic opportunities and constraints—a proxy for market access and lower transport costs. Areas with ease of access or within commuting radius of a city may not be considered rural even if they are agricultural farms, and, towns outside the radius may be considered rural. Economic activities change systematically with distance to city: proximity and remoteness. Lack of an urban core and low overall population density impacts ability to diversify the economic base compared to cities. The most extensively researched source of evidence for the claim that proximity is good for productivity is from studies of areas of dense economic activity: doubling of size increases productivity from 3–8 per cent—from a town of 50,000 to one of 5 million means a 50 per cent productivity increase. Further, this effect is larger in higher technology sectors.

Based on previous research, Reza Ali's work has identified some key spatial features which include the fact that urban built-up areas have expanded well beyond city limits; new suburbs—schemes—have developed around cities; peri-urban growth has gained in significance, grown substantially, acquired 'urban characteristics'; ribbons of development between cities, towns, industrial satellites, along highways have grown and densified; in the more rural areas, densities are increasing along major road corridors; and, the population which has physically not moved to the cities, has adopted *urbanizm as a way of life*, reflected in changing patterns of consumption and use of services. *The cumulative effect of this has been intense urbanization*, city populations are much higher than what official data is prepared to reflect, and there is a connectivity and integration of services and manufacturing access across city boundaries.

(C) Redefining and Estimating Urban and Rural

By defining, estimating and mapping urban and rural *areas* and *population* in these areas, *not* the 'urban' and not the 'rural' population, Reza Ali redefines categories acknowledging that within these areas, there are town populations in the rural areas, and similarly, within the non-rural areas, there are substantial village populations. Areas which can be called 'rural', are areas with thin, scattered populations—low population density, and even higher density areas which do not contain a town, i.e. an urban core. He uses population density of 250 persons/sq.km or less, and an urban core, an absence of a town of 50,000 or more, regardless of density.

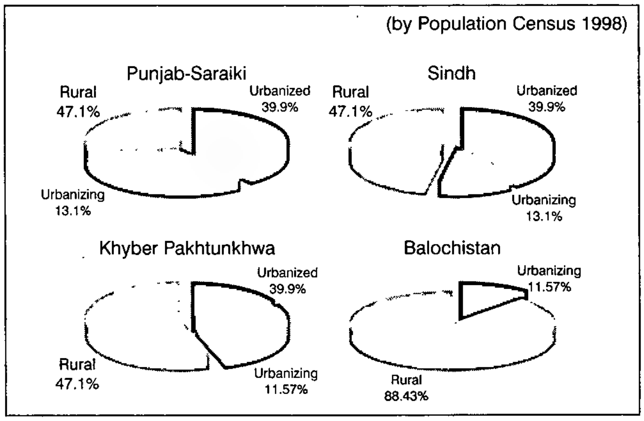
These definitions suggest the following: In the Punjab, while the area is classified as 54 per cent 'urban', the population which is urban is actually 74 per cent. In Sindh, the urban area is only 11 per cent, but the population is 53 per cent urban, and in Khyber Pakhtunkhwa 15 per cent of the area in urban, with an urban population of 45 per cent living in this space. Balochistan which is 99 per cent rural in terms of area, has an urban population—almost all in Quetta—of 12 per cent.

Using different definitions for urban, Reza Ali defines an urbanized area as one with a city core, it's suburbs, built-up areas and linked surrounding areas, has a population of 100,000 or more and a density of 500 persons/sq. km, overall. This criteria is significantly higher than what is considered urban in most of Europe, Oceania, the Americas, Africa, and Asia, and higher than what the US census terms 'urban area'.

Reza Ali makes the argument, that there is no reason to restrict analysis to just two categories—urban and rural—and one can introduce the concept of an 'urbanizing area', which is in area which does not meet the criteria of an urbanized area as we have defined here, yet, it has both an urban core and an overall density higher than that for a rural area. Thus, it's clearly not rural, but, it has not urbanized yet, hence the term 'urbanizing'. Using population size, a minimum of 50,000, and a density overall 250 persons/sq km; and urban core, 400 persons/sq km, Reza Ali defines his 'urbanizing area'. What he terms 'urbanizing' is considered urban in most of Europe, Oceania, Latin America and Africa—with exceptions. In the US, the census term 'urban cluster' comes nearest. Graphs 19.1 and 19.2 and Figure 19.1, redraft the difference in categories for the different terms.

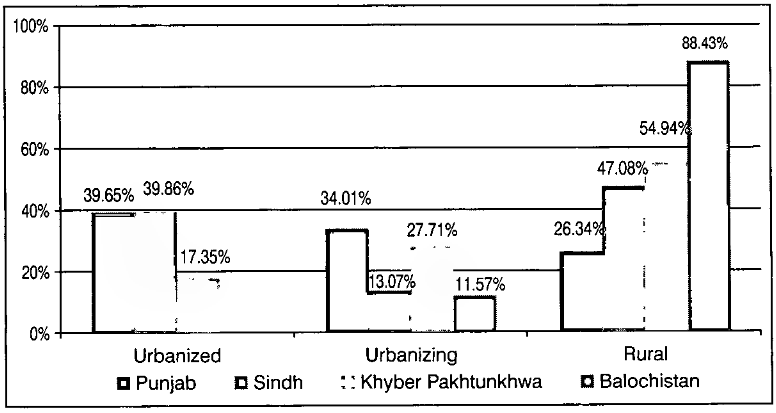
This redefinition and remapping of the urban and the rural, has led Reza Ali to argue, that Pakistan is evolving a system of cities, and developing urban regions—connecting, linking, integrating trade, services, and manufacturing—and the work force—within city core and suburbs, peri-urban areas, satellites, small towns and neighbouring villages. This trend is causing a co-movement of urbanization and informality, and if one examines the relationship between poverty and urbanization, we see that in urbanizing areas and surrounding rural areas—there are positive effects of transitioning out of cropping and livestock with remittances growing, and there is no co-relation to out-migration being captured.

Figure 19.1: How Urban? How Rural?

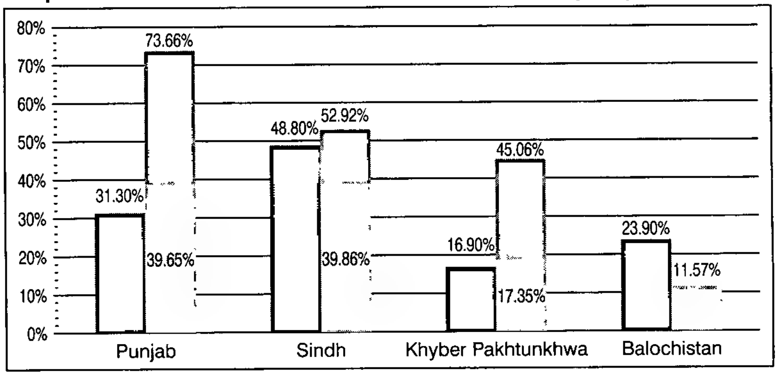


There are clear indications of a developing multi-polar urban, mega-region in central Punjab, which is Pakistan's dominant sub-national economic and cultural space, with a chain of metropolitan regions, substantial urban centres, cities and towns. Reza Ali's seminal work shows that perhaps 98 per cent of the Punjab lives within two hours of a city, 82 per cent about one hour away. Although these are data from the 1998 census and much has changed since then, it could be that Pakistan, or at least a very large part of it, is almost completely urban in 2013—see Maps 19.1 and 19.2.

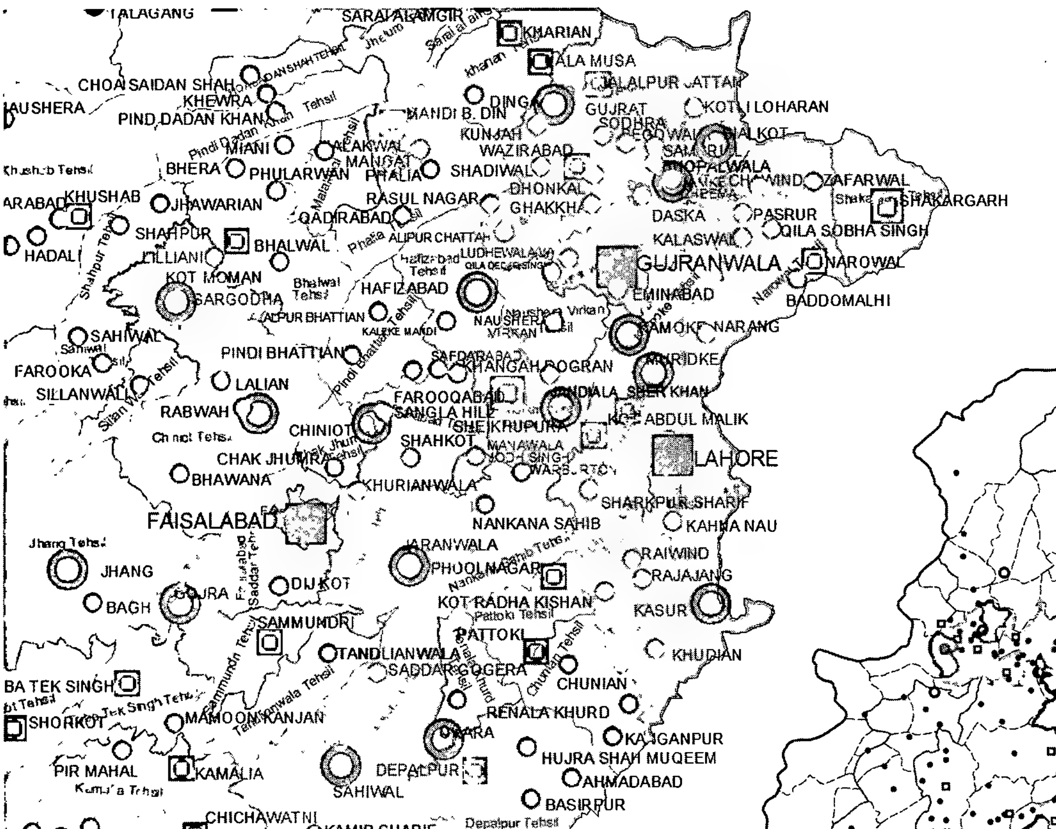
Graph 19.1: Comparing Urbanized and Urbanizing to Unadjusted Urban in 1998 Census

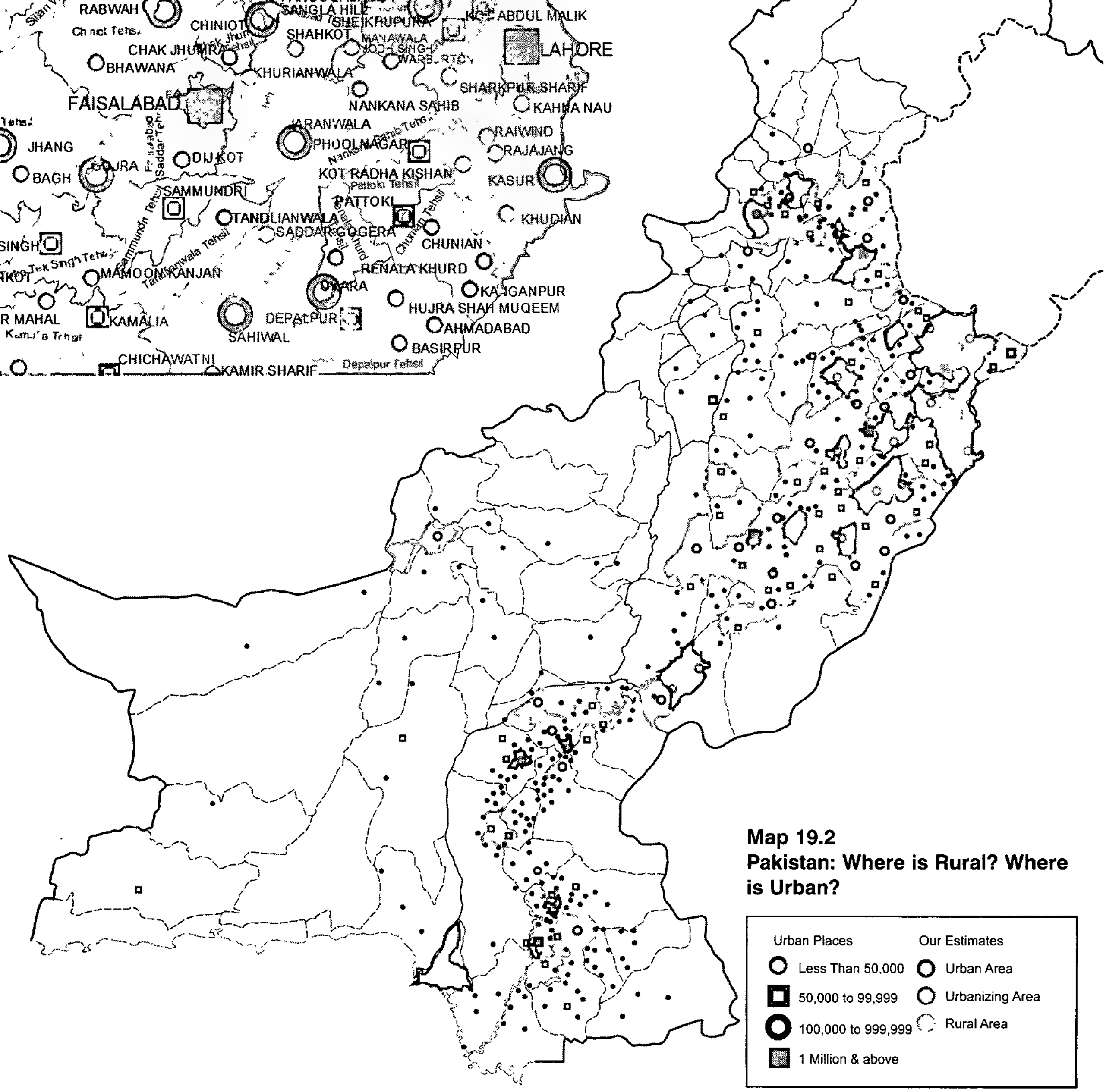


Graph 19.2: Pakistan: How Urban? How Rural? – by Population 1998



Map 19.1: Central Punjab Mega-Region





Map 19.2
Pakistan: Where is Rural? Where is Urban?

Maps: courtesy of Reza Ali

19.5.3 Housing in Cities

While cities may be growing at unprecedented rates in Pakistan, social facilities and services have not been able to keep pace with the growth of natural and migratory populations in cities. Table 19.13 shows that conditions and access to facilities are far better in urban areas than rural areas, which in fact is one of the reasons why people move in the first place, evidence shows that slums and squatter settlements (*katchi abadis*) constitute a large part of the living conditions of the urban population, while health, sanitation, and sewerage facilities in such areas are almost nonexistant. We will examine the reasons for the failure of housing programmes initiated by the government, and how the government's role has been replaced by a dynamic and efficient informal sector.

Arif Hasan, in his *Seven Reports on Housing*,[31] evaluates the causes for the failure of government housing policies, and explains why an alternative, informal market emerged and how it plays a significant role in providing housing to low-income groups.

With reference to Karachi, where many of the problems faced by planners are similar to other cities, except that in Karachi they are on a much larger scale, Arif Hasan highlights the causes of the failure of the Karachi Master Plan programmes. A number of factors are identified:

1. *An affluent middle class*. This class regularly invests in land and considers it a very safe investment. Most official schemes developed by the government and its agencies are purchased by this class for speculation purposes, and the intended beneficiaries are often sidelined.
2. *Development on too small a scale*. The development programmes of the government and the development authorities (like the Karachi Development Authority, the Lahore Development Authority, and the Hyderabad Development Authority) involve schemes that either are too small in scale or take many years to materialize; thus very large amounts of government money are tied up in them unproductively.
3. *The developers' lobby*. There is often a large and powerful political lobby formed by developers, who have a major say in policy formulation, and whose priorities determine many programmes and plans; other political pressures also play a role.
4. *The socioeconomics of the poor*. One of the most important reasons for the failure of government programmes is that government planning is often incompatible with, and does not take cognizance of, the economics and sociology of the poor; hence, there is also a 'cultural gap' between the government and the poor.
5. *The high cost of development and/or lease*. Targeting and affordability are major issues.
6. *People want land immediately*. The lower income groups have a particularly urgent and often desperate need for land and housing, and cannot wait for the development process to be completed.

Table 19.13
Housing Accessibility to Municipality Services in Urban Areas of Pakistan by Province: Selected Years (%)

	Electricity			Inside piped water			Gas piped			Kitchen			Latrine		
	1973	1980	1989	1973	1980	1989	1973	1980	1989	1973	1980	1989	1973	1980	1989
Punjab	16	29	58	7	11	16	1	5	7	20	n.a.	34	19	n.a.	25
Urban	58	73	92	27	36	55	6	17	34	32	35	51	68	57	78
Sindh	21	36	58	13	21	27	5	15	20	17	n.a.	45	48	n.a.	56
Urban	47	68	93	30	43	68	11	33	54	25	60	82	83	74	93
NWFP	24	39	68	5	8	22	0.1	2	4	22	n.a.	46	48	n.a.	58
Urban	66	81	97	23	34	54	1	10	30	35	31	63	76	60	37
Balochistan	5	14	38	5	7	11	0.1	1	3	29	n.a.	37	19	n.a.	29
Urban	27	55	86	28	37	67	1	4	34	53	57	82	66	64	87
Pakistan	18	31	59	8	13	18	2	6	9	20	n.a.	38	29	n.a.	35
Urban	54	71	93	28	38	60	7	20	41	30	44	63	55	63	84

Source: Asian Development Bank, *Pakistan Urban Sector Profile* (Manilla: Asian Development Bank, 1993).

7. *Framing and implementation of government policies.* Since the urban poor have no representation in the framing of national policies, most policies—not only those related to housing—cater to the needs of the middle and upper classes at the expense of the poor. Moreover, technocrats and policymakers belong to the upper sections of society, and do not have or wish to have a proper understanding of the issues of the urban poor.
8. *Powerless municipal corporations.* Development authorities work in parallel to elected bodies like municipal corporations, and are not answerable to the corporation and hence to the people. The technocrats who constitute these authorities have to give in repeatedly to political pressures and modify their programmes, making a mockery of the planning process.

Because of the failure of government programmes and policies regarding land and housing, the informal sector has emerged and consolidated itself over the years and has built numerous institutions. It has been estimated that as much as 63 per cent of Karachi's annual housing needs are fulfilled by the informal sector.[32] The informal sector does everything that the formal and government sectors do not. It 'provides land, with immediate possession, at affordable prices; arranges for water supply to the townships it develops, and successfully lobbies with government agencies for acquiring electricity and transport. In addition, the building component yards in these areas provide materials on credit to the poor and give technical advice on house building. All this is done in defiance of government regulations.'[33] Moreover, the informal sector has, unlike the formal sector, a great deal of appropriateness for low-income groups. For example, the locations selected and developed by the informal sector are often closer to the workplaces of the urban poor, or have adequate access through roads and transport. The allotment procedure for plots is also simple, unlike the cumbersome red tape of the formal sector: 'there is no catering to corruption, no visiting banks and fulfilling other formalities'.[34]

Arif Hasan, in his evaluation of the role of the formal and informal sector in housing, concludes that attempts should not be made to formalize the informal sector. He writes that

> it must be clearly understood that the formal sector planning and delivery mechanisms as they are structured today cannot serve the urban poor. It must also be understood that the formalizing of the informal sector on the formal sector terms, can adversely affect the informal sector operations and make it all the more difficult for the poor to acquire land for housing.[35]

The inability and unwillingness of the formal public sector in housing, as in other social sectors, has resulted in people having to turn to the informal or private sector.

19.5.4 The Demand for Low Income Housing in Pakistan

According to various sets of statistics available from the Government of Pakistan and from the State Bank of Pakistan, the official housing finance market in Pakistan is very small compared to its potential and to comparable countries in the region and in Asia. The most recent set of data, from December 2007, show that while the housing finance market in Pakistan may have more than doubled in just two years, from 2005, growing to Rs. 126 billion in 2007, it was still less than 1 per cent of GDP.[36] Moreover, since 2007 when there has been a significant slowdown in Pakistan's economic growth, matched with a tight liquidity squeeze and a reluctance on the part of banks and housing finance companies to lend, it is clear that this proportion would have fallen to far less than even this minuscule amount.

The State Bank of Pakistan's assessment about these 'low numbers in housing finance', suggests that these trends have 'aggravated the housing shortage in the country', being partly responsible for a housing shortage calculated at 4.3 million housing units in 1998, estimated to have risen to around 6 million units in 2005 and according to these projections, it would be closer to the 9 million mark in 2009–10.[37] The annual construction rate on the other hand, is supposed to be around 300,000, adding to a growing annual shortfall. Nevertheless, despite these rather dismal sets of numbers, most people—according to some estimates as many as 80 per cent of the population[38]—live in and own their own houses. Clearly, there is far more at play than these official numbers reveal.

Over the last few decades, the role of the government in the housing sector has shifted from one that earlier used to provide housing, to one now where it is essentially a facilitator of housing facilities. This shift has led, even in the case of the government's share of housing in public sector programmes, to fall from around 10.9 per cent in the 1960s to 5.9 per cent in the 1990s, and probably far lower today as the role of government overall has declined.[39] The expanded role of the private sector is now well recognized in official housing (and other) policies, and the National Housing Policy (NHP) of 2001, also emphasized this role. The NHP recognized that housing is linked, along with other issues, with that of financing as well, and that is why the State Bank of Pakistan also had a strong linkage with the NHP. There is recognition that a key constraint to housing in Pakistan 'is the lack of financing capacity of the poor, as well as a low penetration of housing finance, especially in the poorest segments of the population'.[40] Clearly, any desire to address the shortfall in housing in Pakistan must be linked to financing needs as well.

Financial sector reforms in the 1990s made it possible to start thinking about financing for the housing sector, and that is one reason why the State Bank of Pakistan set up a Housing Advisory Group 'to iron-out housing sector-related issues which are critical to the promotion and development of housing finance'.[41] While finance has been a key constraint towards expanding the housing market in Pakistan, particularly for the low income segment, endemic issues related to the legal and regulatory framework for housing finance, issues around land registration and titling, and such other key constraints have been impediments as well.

Availability of Housing Finance in Pakistan

Three studies supported by the State Bank of Pakistan which deal with housing finance provide the following insights related to issues regarding the housing sector, more broadly. (Unfortunately, for our purposes these three studies focus on the 'higher end of the income market' which they define as 'households earning more than Rs. 15,000 per month', and do not deal with 'non-bankable households').

Only 1 to 2 per cent of all housing transactions in Pakistan are processed through housing finance institutions; otherwise, most housing finance comes from personal sources. Probably 10 per cent is estimated to be the informal lending sector. These studies argue that the lack of finance is primarily a supply problem. In March 2008, private banks had a share of 59 per cent of the financing advanced to the housing market, with public sector banks providing 13 per cent, Islamic banks 11 per cent, and the House Building Finance Corporation (HBFC) 13 per cent of the total amount made available. The average loan size of banks (excluding HBFC) was around Rs. 2.82 million, with that of HBFC approximately Rs. 90,000. The loan portfolio in this market revealed that the highest proportion was comprised of outright purchase loans, followed by construction loans and loans for the purpose of renovation.[42]

Other than the State Bank of Pakistan's studies and reports mentioned here, some independent studies have also examined the housing finance sector. Uzma Hussain's study for the Pakistan Microfinance Network, which builds largely on Sabbah Rahooja's thesis on Determinants of Housing Demand across Income Groups in Pakistan (LUMS, 2007), has the following findings which substantiate this study:

- housing microfinance generally supports home improvement, although some smaller starter units also get their funding from this source;
- the bulk of most households build their unit incrementally over 5–15 years;
- and, incremental housing entails main potential for funding;
- short and medium-term loans should be the main focus of finance providers.[43]

Issues in the Financial Sector with an Impact on Housing Finance

Issues related to housing finance, whether for the formal sector or the informal, whether for the higher end of the market or for the lower income segment, cannot be considered outside the larger financial market and the extent of access to finance by the population at large.

The recent *Access to Finance Study* undertaken by a number of international and local key actors in the field of finance in Pakistan on the request of the Ministry of Finance and the State Bank of Pakistan, conducted over 10,000 interviews—questionnaires, interviews, focus group discussions (FGDs)—to assess the nature of finance in Pakistan. The purpose of the study was, to monitor and measure 'levels of access to formal financial services that can assist in achieving goals of growth and poverty alleviation in addition to helping policymakers, practitioners, researchers and the private sector to more fully understand the current and potential supply and demand for financial services'.

The main findings of the Access to Finance Survey were as follows:

- 89 per cent of Pakistanis, urban and rural, are unbanked, and only 38 per cent of these would like to open a bank account.
- 56 per cent of the total adult population saves/invests either formally or informally; however, 53 per cent save informally while formal savers are only 3 per cent.
- 84 per cent of males and females, in urban and rural areas, are part of at least one 'committee' (*bisee*).
- Contrary to common expectations that money lenders are the ever pervasive source of loans and credit in the informal sector, overall, only 3 per cent people borrow from them, while 78 per cent borrow from the local shopkeepers/grocery stores.
- 70 per cent of urban residents take loans from shopkeepers; 55 per cent from family and friends, and most borrow to purchase food.
- 80 per cent of urban households own their houses.
- Only five per cent of urban dwellers actually borrow money, either to purchase, build or renovate their residence.[44]

Clearly, in both cases, those related to housing (and, hence, housing finance) as well as the financial sector more generally, it is clear that most of the population—and not just the low income sector—are 'outside' the formal sector net. Most individuals for their financial and housing-related needs, work through the informal sector, either taking credit or making savings. For this reason, microfinance institutions and microfinance banks have stepped in to capture some of the market which has been informalized in the past. The government and State Bank regulations in recent years, have also encouraged the growth of microfinance institutions over the last decade. Such institutions have made some interventions in the housing finance sector, as indicated above, but not only is the microfinance sector very small—around 2 million clients—but the microfinance sector, barring a few innovative schemes, is also in a nascent stage of development.

The quoted figure of eighty per cent 'ownership' of housing in Pakistan is an ambiguous figure for at least two reasons. Firstly, we really do not know whether 80 per cent of households live in their own personal abodes—a highly unlikely probability—or whether 80 per cent of the housing structures across Pakistan are owned by the household, family or families, who live in them, a more plausible and likely possibility. Furthermore, when policymakers or investors use the 80 per cent figure to devise housing-related initiatives, i.e. when they try to assess whether there really would be any demand for housing at a time when 80 per cent of houses are self-owned, there are further complications. Add to this the fact that some researchers question the figure of a 6–9 million shortfall in houses, and we can see clearly, that there is really no lucid picture or understanding of the size of the housing

market in Pakistan. If we accept the most likely interpretation of the 80 per cent 'ownership' explanation, that 80 per cent of accommodation is owned by one of the family members who live in it, then, clearly, there is demand for housing.

19.7 Summary and Further Reading

19.7.1 Summary

Despite high growth in the economy, the social sectors have shown poor performance over the last 66 years. This, the first of the three chapters on the social sectors, which has tried to explain the factual position in education, population welfare, and housing. The chapter began by comparing other countries in the South Asian region, along with other underdeveloped countries at similar levels of development. The evidence very clearly suggests that while Pakistan's economic growth performance in the past had been far better than these countries, its social development has been markedly poor. It seems that the high rate of growth in the economy has not translated into better social indicators.

A detailed evaluation of the education, population, and housing sectors suggests a large number of common threads. In the education sector, private sector schools now dominate. Although there has been an increase in government facilities, their quality has noticeably deteriorated, and a private sector in education, even one which addresses the needs of low-income consumers, is thriving. Female literacy, probably the most important of all social sector indicators, is still extremely poor, and fewer girls go to school than boys do, although this too might be changing as we show in Chapter 20, with the former having higher drop-out rates than the latter. Education is now increasingly being seen as the key to economic development, as the experience from East Asia suggests (see Box 19.4). Hence, this sector must receive high priority in years to come, and increasing the number of schools for girls, must be at the top of the agenda.

Pakistan was one of the first countries to launch a population welfare programme, yet it has had the highest population growth rates in the world. Fortunately, though, this rate has fallen over the last few years. We argue that economic factors might be the explanation for smaller families, as it becomes more difficult to afford larger ones. In addition, as the status of women improves and as more are educated women join the labour force, we are likely to see lower population growth.

The proportion of the population in urban areas has increased from 18 per cent in 1951 to anywhere between 60 and 70 per cent today. The urbanization phenomenon is visually evident, and the number and size of small and large towns have been growing. We have shown how the urban population has adjusted to its situation, turning to the informal and private sectors at an increasing rate. We also question the notion of 'urban' and 'rural' as two binaries, arguing that it might be better to see them as a continuum.

19.7.2 Further Reading

For a general overview of the social sectors and in order to make comparisons over time and across countries, the World Bank's annual *World Development Report* and UNDP's *Human Development Report* are essential references. Ajaz Aslam Qureishi's *Development Planning in Pakistan* (Lahore: Ferozsons, 1991) also has a number of articles on different aspects of the social sector. Tariq Banuri (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Karachi: Oxford University Press, 1998) covers a large number of issues that affect the economy—in particular, the social sectors. To understand issues on housing, see Arif Hasan's *Seven Reports on Housing* (Karachi: OPP-RTI, 1992). See also Imtiaz Alvi's *The Informal Sector in Urban Economy: Low Income Housing in Lahore* (Karachi: Oxford University Press, 1997); Hameeda Khuhro (ed.), *Karachi: Megacity of Our Times* (Karachi: Oxford University Press, 1997); and S. Akbar Zaidi's, *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999). Recent books that look at some of the themes discussed in this chapter include two by Arif Hasan: *The Unplanned Revolution* (Karachi: City Press, 2002), and *Understanding Karachi* (Karachi: City Press, 2002).

The *Annual Review* of the Social Policy and Development Centre in Karachi, and the annual *Human Development in South Asia* reports of the Mahbub ul Haq Human Development Centre in Islamabad, are essential reading for anyone interested in the social sectors of Pakistan. An article by William Easterly 'Pakistan's Critical Constraint: Not the Financing Gap But the Social Gap' (Washington DC: Development Research Group, World Bank, February 2001) is difficult to obtain but very useful and highly recommended. On the population and the 1998 Census, see the edited volume by A. R. Kemal et al. *Population of Pakistan: An Analysis of 1998 Population and Housing Census* (Islamabad: PIDE/UNFPA, 2003).

For some excellent analysis on urban areas, see Mohammad Abdul Qadeer, *Pakistan: Social and Cultural Transformation in a Muslim Nation* (New York: Routledge, 2006) especially Chapter 5. Also see his 'Ruralopolises: The Spatial Organization and Residential Land Economy of High-density Rural Regions in South Asia', *Urban Studies*, vol. 37, no. 3, 2000; and 'Urbanization of Everybody: Institutional Imperatives and Social Transformation in Pakistan', *Pakistan Development Review*, vol. 38, no. 4, Part II, 1999.

Box 19.4

Is Education the Key to Development?

Experience from East Asia suggests that education is perhaps the key to development. What can the rest of the world learn from the classrooms of East Asia?

Many theories about East Asian economic success are controversial. Economists argue about the importance of industrial policy, cultural critics debate the existence of 'Asian values'. But one explanation commands almost universal assent: an emphasis on education.

The success that countries like South Korea and Taiwan make of educating their children is often held up as an example for poorer countries in South Asia and Africa. But international comparisons also regularly show that East Asian children outperform their western counterparts when tested on their knowledge of maths and science. In the 1995 World Competitiveness Report, Singapore and Taiwan were rated first and third on the ability of their educational systems to meet 'the needs of a competitive economy'.

One of the most striking characteristics of countries like Taiwan, Singapore, and South Korea has been their emphasis on raising the educational standards of the whole population rather than an élite. Moreover, those developing countries that invested heavily in primary education have done much better economically than those that concentrated more on university education. In 1960, Pakistanis and South Koreans were about as rich as each other. But whereas just 30% of Pakistani children were enrolled in primary schools, 94% of South Koreans were. By the mid-1980s, South Korea's GDP per person was three times Pakistan's. Hard as it is to prove a direct connection, the figures are certainly suggestive.

But it is not just developing countries that are looking to the East Asian tigers. In America and Britain in particular, education debates have recently been shaped by arguments about what Asians are doing right and westerners are doing wrong. Tests of schoolchildren seem to show that the best of the West match the achievements of successful Asian schoolchildren. The great weakness of the rich nations and one of the reasons their test scores look so bad compared with the East Asians is that many more western children fail at school. These, the failures, end up on the periphery of the labour market and often on the welfare rolls. That the wages of the unskilled in the West are falling steadily suggests that the social and budgetary costs of educational failure are certain to increase.

Unlike South Asians and Latin Americans, Americans and Britons cannot blame their relative failure on a lack of universal primary education. So some westerners are inclined to shrug their shoulders and say that East Asian children are naturally more diligent or even more intelligent (a conclusion many Asian may quietly agree with). In any event, the achievements of Asian children brought up in the West suggest that cultural explanations, such as family support, may have a part to play. The success of Asian-Americans in gaining admission to élite universities like Harvard and the University of California has been so marked that it has provoked rows about discrimination against Asians, as the universities attempt to maintain an ethnic balance among their students.

Simply copying teaching methods may not compensate for cultural advantages like a deep commitment by parents to education. In South Korea, Taiwan and Japan, many children are sent to cramming schools in the evening to supplement their daily lessons. Examinations dominate the lives of the young far more than in the West. This may not make adolescence much fun, but it probably raises test scores.

The West is unlikely suddenly to acquire Asians' cultural traits, but it may still be able to learn from the tigers. The most impressive characteristic of their education systems is the belief that everyone can and should succeed. It is expected in Taiwan, for example, that every child will achieve a basic level of attainment by the age of 12. Classes in the first three or four years are of mixed ability. Those who fall behind are given special tuition in one-to-one catch-up classes. Primary schools tend to be much more alike in terms of the money spent on them, class sizes and exam results than in the West. The 'sink school' is not something that exists in Taiwanese.

Other factors may also contribute to the tigers' success. Their children work harder, with more days in the school year and more hours in the school day. Educational objectives are kept to a minimum and there is little debate about the nature of subjects and much concentration on the absorption of facts. A daily report on each child's progress is supplied to parents and the head teacher randomly inspects children's homework to monitor their progress and the form teacher's performance. Teachers enjoy considerable respect and prestige and are relatively well paid, compared with their counterparts in the West.

East Looks West

The Asian example is beginning to influence educational policy in the West. It has helped, for example, to bring regular tests and whole-class teaching back into fashion in Britain. Ironically, though, some Asian educationalists are beginning to voice doubts about their own methods. The strength of their educational system, with its emphasis on discipline, facts and learning by rote, may also be its weakness.

Some more advanced Asian countries, like Japan and Taiwan, are worried that current ways of doing things are stifling creativity and inventiveness among their students and that this may eventually carry an economic price. Manufacturing, with its emphasis on systems and teamwork, rewards the kind of disciplined and fact filled students produced in the tigers. But what about the more creative service industries in which Asian countries currently lag behind America—like software design or entertainment?

Yuan-Tseh Lee, who chairs a commission currently looking into education reform in Taiwan, is brutally critical of the exam system and its inability to identify and encourage original talent. Similarly, Professor Hiroyaki Yoshikawa, the president of Tokyo University, says that Japanese employers are increasingly complaining that new graduates are unable to think for themselves. He laments that students returning

from the West are at first full of enthusiasm and ideas, but that this tends to be soon crushed by the Japanese system. Creativity and independence, however, are not qualities that can be readily manufactured. A big shift may take decades.

Meanwhile, educational priorities in the more-established tigers are now moving towards higher education. Over 10% of American doctoral degrees in science and engineering in 1990 went to students from Taiwan, China and South Korea—a legitimate source of Asian pride, but also a comment on the state of universities back home. In 1991, in a league table comparing the proportions of 20–24-year-olds in higher education, South Korea was tenth, Singapore 11th and Taiwan 20th, with Canada and the United States leading the ways. But change is on the way. Taiwan hopes to raise the share of its young who go to university from 18% now, to 30% by 2000. As in the West, a huge university expansion is under way. As both East and West revamp their education systems, lessons will flow in both directions.

Source: *The Economist*, 21 September 1996, 29–30.

Appendix 19.1

The Changing Role of Planning in Pakistan

Although planning by the public sector is no longer in vogue, and the private sector now dominates much activity, especially in the social sectors as we have just shown, planning in the public sector used to play a critical role in the past. Professor S. M. Naseem presents an evaluation and history of the planning process in Pakistan, and identifies the changing role of government and the private sector over the years.

During the past four decades, Pakistan has had a succession of seven Development Plans. The political and administrative environment in which the various plans were implemented have, however, changed considerably over time. The first three five-year plans were undertaken in the context of a larger territorial boundary, which included the present day Bangladesh. The second and third plans coincided with the regime of President Ayub Khan in which a strong central government, assisted by a well organized bureaucracy and with minimal democratic support but strong Western foreign aid programmes, laid the foundation of a planning machinery that was then considered all-powerful. The superstructure of planning inherited from the 1960s continued into the 1970s and 1980s, but with considerably reduced influence and eroded authority.

The erosion in the credibility and effectiveness of the planning machinery inherited from the second and third five-year Plan period has been the result of many factors. The separation of East Pakistan and the dissolution of One Unit gave a new dimension to the regional problem in Pakistan, which during the first two decades was primarily focused on the disparity between East and West Pakistan. The minority provinces, especially those of Balochistan and NWFP, which had been relatively underdeveloped and where political parties opposed to that in the centre were voted into office, brought the regional issues to the forefront. In any event, planning itself was relegated to a relatively less important role as political and ad hoc decision making became more important. Many of the economic decisions taken by the People's Party's government were outside the planning framework and were motivated by its own ideological considerations and were reversed soon after the imposition of Martial Law in 1977. These domestic factors greatly weakened the planning machinery established in the late 1950s and strengthened in the 1960.

The planning machinery inherited from the Ayub era has also been under pressure from the changing importance of foreign aid, the channelling of which was one of the principal objectives it was geared to achieve, if not its real raison d'être. The second and third five-year plans were largely financed through foreign aid. Aid financed investment in water, power and transport and strengthened the infrastructural base—Tarbela and Mangla dams being the prime examples. Industrial development also received a high priority and was the largest recipient of project aid. In addition, programme aid was used to liberalize imports and augment the supply of needed industrial inputs, which had a favourable effect on industrial growth, through better utilization of industrial capacity.

Indeed, during the Third Plan period the essentiality of foreign aid to Pakistan's development was highlighted when the country's foreign assistance programme was suddenly brought to a halt in 1965 as a result of the war with India. Import liberalization schemes had to be reversed and import substitution in consumer goods became the main vehicle of growth. When aid was resumed, attention was shifted to agriculture and since the mid-1960s, industrial progress has failed to gain the momentum it achieved in the early 1960s. The suspension of, or interruption in, aid, based on political considerations, was again repeated, albeit in different contexts, in the 1970s and 1980s. This has rendered foreign aid as a considerably less reliable basis for planning than in the earlier phases of long- and medium-term planning in the country. Foreign assistance for structural adjustment reasons, however, has become more important since the 1970s in the wake of the oil price shocks and terms of trade deterioration.

The emerging geopolitical changes in the world economy have also dampened the climate for aid on which past successes in Pakistan's economic development were based. Both the increasing demands for concessional assistance, and its reduced supply, will force the country to choose either a deceleration of its growth rate or an increasing reliance on commercial borrowings, or increased efforts for

domestic resource mobilization. The first two options, clearly, are unacceptable in view of their implications for poverty alleviation and debt servicing, and therefore, the only real option is the last one. This is an option which planners and policymakers have tried to their utmost to shy away from, partly because they have lost the authority to make such decisions. But if the option becomes unavoidable, as seems likely, it would require changes in the structure, as well as the policy thrust, of the present planning machinery.

While the main achievement of the planning machinery in Pakistan has been its considerable success in maintaining relatively high growth rates of GDP, largely through attracting large amounts of foreign resources, its record in attaining a balanced development, especially in the social sectors, and in mobilizing domestic resources, has been generally considered deficient. Pakistan's development has been highly dependent on the inflow of foreign resources, which have varied from about half the level of total gross investment in the 1960s, to a quarter in more recent times. The quantum of net aid flows in recent years has fallen—largely as a result of increasing requirements of debt servicing—but the dependence on gross aid inflows remains high. Much of the aid flows in recent years has been accompanied by a high degree of conditionality or of external policy advice, decreasing the need for a strong planning machinery capable of taking autonomous and innovative initiatives at planned development. Not all policy advice given by aid donors is necessarily bad and some has the distinct advantage of being otherwise disregarded as impractical or unpalatable, even when considered necessary. Such advice can, to a limited extent, be considered a blessing in disguise as it enables the planners to take unpleasant decisions. However, in general, external policy advice does deprive the planners of making autonomous decisions about the long-term and medium-term objectives of the economy. To what extent it is necessary or desirable to restore this autonomy in a period in which the relative roles of domestic and foreign resource mobilization must undergo a sea change in favour of the former, is clearly a question that needs to be addressed in all earnestness in the Eighth Five-Year Plan.

Another consideration which has affected the role of planning in Pakistan is the growing emphasis being laid on increasing the role of the private sector, in both productive and infrastructure sectors. Pakistan's early industrialization was based on the heavy involvement of the public sector in both industry and infrastructure. Lack of entrepreneurship, the low capital base of domestic enterprises and their inability to undertake large and risky projects, as well as the need for providing essential infrastructural support for the nascent industrial sector, provided a powerful argument for such a positive role of the public sector. Over time, however, the private sector overcame its 'shyness' and some of the public sector industries were handed over to the private sector. Import controls, tariffs, and an overvalued exchange rate encouraged the development of a private sector, which became increasingly powerful and oligopolistic in nature. By the end of the 1960s, fears of over-concentration of industrial power gave rise to the phobia of twenty families. These perceived fears later led to large-scale nationalization of industries, banks and financial institutions, causing panic and fear in the private sector. Many industrialists were tempted away to the Gulf region where business opportunities were plentiful in the wake of the oil boom of the mid-1970s. Others found real estate and other rent seeking endeavours, often obtained through political patronage in an unstable environment, as a profitable avenue for investment. The underground economy flourished and adversely affected the economy's productive potential, adding to the growing list of social problems such as drug abuse, urban crime, and ethnic strife.

The reversal of the nationalization policies undertaken in the 1970s has not been easy and despite the government's best efforts, private investment in the Fifth and Sixth Plans has not grown rapidly or in the desired directions. During the Fifth Plan, the result of the government's efforts to reduce the role of the public sector was manifested not in any crowding-in of private investment, but in the decline of the investment ratio from 16 per cent to 13.4 per cent. Private investment grew at 6.3 per cent per annum during the period. In the Sixth Plan period, the growth rate of private investment accelerated to 16.6 per cent through a variety of policy initiatives to provide incentives to private investment, which included deregulation, disinvestment, improved credit facilities, rationalization of sanctioning procedures, as well as a reduction in tariff rates. However, private investment did not move into priority sectors identified by the Plan, such as production of capital goods, export-oriented industries, and investment in backward regions. It moved largely into highly protected consumer goods and other import substituting sectors, as well as into rent seeking non-productive activities.

A major problem facing the planners in the Eighth Plan will be a clear delineation of the functions of the public sector and devising policies which would aim at increasing and channelling private sector investment into priority areas of the economy, including physical and human infrastructure. Public policies, including public sector investment policies, will have to be reoriented in order to create a supportive environment for the private sector, and for acting as a catalyst for the country's industrial restructuring. At the same time, it would be necessary to keep in mind that the market does not always pursue activities which may be considered socially desirable. Can the private sector, for example, be relied upon to undertake investment to promote primary education or in rural health projects? The market mechanism is good at producing things efficiently, but it does not always help in building the economy's productive base. Does the encouragement of the private sector necessarily imply the abandonment of the government's role of redirecting resources according to plan objectives? In the Pakistani context, has the private sector broadly fulfilled the role that the planners had hoped it would achieve? What policy measures, if any, need to be taken to ensure a more coordinated role between the private and public sectors?

This is where the complementarity between planning and the market mechanism needs to be brought about. Planning is a useful tool—and can still remain so—to identify to achieve socially desirable goals. But it has to be supplemented by enabling economic agents—both private and public—to achieve these goals. In the past Plans, while much attention was paid to achieving the goals and even in fixing the targets to be

achieved by public and private sectors, there was relatively little attention paid to incentives to induce the private sector to invest in priority sectors. A strategic role of the government and the planning machinery would be to correct, or avoid, the likelihood of information failure by the public sector, i.e. the inability to assess the social value of any particular piece of information of consequence to the country's development.

Source: S. M. Naseem, 'Major Issues for Consideration in Formulating Pakistan's Eighth Development Plan: A Preliminary Appraisal', mimeo, July 1990.

What is the role of planning in an era when the role of government has been much maligned and the concept of planning seems to be pushed off the agenda?

The Ninth Five-Year Plan is being envisaged, and is to be launched at a juncture, when a virtual consensus has developed in favour of the market mechanism as a fundamental tool to achieve efficient resource allocation across sectors, agents and regions. This consensus has roots in the general disillusionment with Plan outcomes involving a substantial role of the public sector, both nationally and globally.

With this heavy reliance on markets to allocate resources, it may legitimately be asked, whether a development planning exercise has any role in the first place? It is argued that planning does have a role, albeit in a different form than has been conceived in the past, simply because the gap between market determined results and socially desirable outcomes may still remain substantial. Desirable outcomes such as sustained growth and distributive justice are results which the market may not necessarily deliver. At best, allocation of resources through the market takes an economy up to its production possibilities frontier, but who the beneficiaries of growth are will depend on relative resource endowments and prior distribution of income and assets. Thus, distributional outcomes of the market mechanism may serve to reinforce the status quo or even accentuate inequalities. Apart from its ethical implications, such a strategy is politically infeasible as was provided in Pakistan in the 1960s. Moreover, reaching the production possibilities frontier also does not say anything about the sustainability of long term growth, because long term growth entails pushing this frontier further outwards. As much of the recent literature in new growth theory has highlighted, this frontier can best be moved through allocating resources to sectors which generate positive externalities that can be captured at a subsequent date.

From the above statement it stands to reason that planning still has a significant role to play in the development process. Since planning through direct controls and severe distortions of prices has not worked because of unfavourable implications on efficiency, new mechanisms for allocating resources into economically desirable sectors and to specially desirable groups will have to be sought. Thus the theme for future planning will have to be strategic intervention in areas and sectors which have the potential to generate positive externalities, and greater growth, and where the benefits of growth are more widely dispersed.

Whether such externalities are captured and resources are actually diverted to intended beneficiaries will also depend critically on institutional reform. While planning mitigates perceived market failures, effective governance structures are a necessary condition for reducing the scope of government failure. Thus, for effective development planning, economic interventions have to be accompanied by institutional reform. The need for such reforms has never been as obvious and critical as it will be in the Ninth Plan Period as we turn the century.

Source: Social Policy and Development Centre, Ninth Five-Year Plan (1998–2003) Issues Paper, Karachi, 1996.

Appendix 19.2

Underestimating Urbanization

In a path-breaking article, Reza Ali examines the urban/rural divide making a convincing argument that Pakistan's urban population is severely under-reported.

In transitional societies, urbanization, and its key characteristics, are major determinants of the political process. Independence, the historically significant areas of poverty and social deprivation and their commensurate societal structures, and, explicit economic policies adopted by governments have contributed to the shaping of urban systems and hierarchies in Pakistan.

The differentials and variations in the sub-national context of urbanization, and its implications for participation of citizens in the political process, need to be understood in a historical context. We argue here that although an analysis of inter-censal data would highlight major demographic trends in the national context—and the 1998 census allows for an up to date analysis—a number of important aspects of the current urban demography are not captured. Leading Pakistani demographers and social scientists (Dr M. S. Jillani, Sultan Hashmi, Dr Akthar Hasan Khan, G. M. Arif and others) have commented upon, raised questions or offered explanations for apparently low urban growth rates given higher projections made prior to the census by the Planning Commission, M. S. Butt, Shahid Javed Burki and others. Some of these outstanding questions are addressed here.

At the turn of this century, the population of what is the geographical area of Pakistan today, was 16.5 million. The urban population, 10 per cent of the total population, was growing at one-quarter of the overall growth rate of 1.6 per cent per annum. However, global forces such as the two World Wars and the Great Depression of the 1930s and local economic policies such as the development of canal irrigation saw changes in this dispersion: by 1941 the population had reached 28 million, 15 per cent of which was urban. Most significant, however, was the fact that the urban population was growing at twice the overall growth rate and nearly three times that of the rural.

Independence brought the first major change in the political economy of urbanization. At Independence in 1947, the population was almost 31 million of which about 5 million was urban. A number of subsequent urban regions, systems and hierarchies that have developed can be traced back to the nature of the in-migration and the settlement patterns of Muslim population that migrated to the new homeland. In what has been termed as the single largest movement of population ever recorded in history, nearly 11 million people left their homes. Pakistan's population in 1951 was 33.8 million of which 6.5 million were migrants to the country—this represented 19.3 per cent of the national population, with the transfer of population resulting in a net gain of over 1.8 million or 5.4 per cent. Moreover, the distribution of these migrants across the provinces was uneven: while NWFP recorded a net loss of population, Punjab had the greatest net increase (26 per cent), second to that Sindh (19 per cent), and then Balochistan. Moreover, significant numbers of migrants tended to head towards the urban areas: in 1951 while nearly one-fifth of the population comprised Muslim 'refugees' from India, they comprised 45 per cent of the urban population and 15.6 per cent of the rural; in Punjab, which had 5.3 million migrants (or 81 per cent of the total), they comprised 46 per cent of the city population and in Sindh made up 54 per cent of the urban population. Lahore, which had been the largest city since census taking began under the British, was pushed into second place by Karachi in 1951.

The 1998 census reported Pakistan's urban population as 42.458 million and is growing at a rate of 3.5 per cent p.a. For the period after Independence (1951-98), the national annual growth rate of Pakistan fluctuated from 2.4 per cent in 1951-61 and 3.1 per cent in 1972-81 to 2.6 per cent in 1981-98. Urban areas grew significantly in this period from 6 million in 1951 to 43 million in 1998: the urban population of Pakistan, as a percentage of total population, has gone up from approximately 18 per cent to over 32 per cent since 1951. This increase has been fairly significant in all four provinces: in NWFP this has gone up from 11 per cent to 17 per cent, Punjab from 17.5 per cent to 31 per cent, in Sindh 30 per cent to 50 per cent and Balochistan 12 per cent to 23 per cent.

Between the censal period 1951-61 and 1961-72, the momentum of urbanization varied between the provinces. Sindh experienced a higher urban growth rate—3.3 per cent and 4.6 per cent respectively—than the national urban growth rate. However, for the period 1972-81 and 1981-98 the urban growth rates in Sindh, Punjab and NWFP have been similar at around 3.5 per cent p.a. Although, each province experienced a difference in how their urban systems developed in this period, with different provincial hierarchies, patterns of urban development and urbanization trends, today the major issues and phenomena are common to all provinces.

Firstly, is the issue of definition. Until 1972 the same definition and system for the classification of urban areas was used. An area was regarded as urban if it had a minimum of 5,000 inhabitants or had the administrative status of a municipal corporation, municipal committee, town committee or a cantonment board (regardless of population size). In addition, Census Commissioners had the discretion to consider any area as urban that had 'urban characteristics'. The discretion given to Census Commissioners on classifying an area as urban was removed and standardization was brought in for the 1981 census based on an administrative criterion wherein only those areas were considered urban which were municipalities, town committees and cantonment boards This has probably resulted in the under-estimation of the urban population. In 1981, 1462 places with a population of 5000 or more were classified as rural; it is not possible to determine how many of these would have been classified as urban under the earlier definition.

Secondly, administrative boundaries were used in the 1998 census. This meant that people living outside the administrative boundaries were not counted in the urban category. As city populations have extended outside these administrative boundaries, this has resulted in an under-estimation of some magnitude. In Lahore, public sector developments such as for instance Johar Town, Sabzazar Housing Scheme, most private sector development, and, the Defence Housing Authority area were not included in the estimates for the population of Lahore. Thus the proportion of the population living in the rural areas of the Lahore district went up in 1998 compared to 1981 with the 1981-98 annual growth rate for urban population being 3.2 per cent compared with 4 per cent for the rural. Re-estimating the urban agglomeration would result in an almost 20 per cent increase—a difference of nearly one million—in the urban population of Lahore.

Thirdly, the phenomenon of peri-urban areas has gained in significance. Settlements peripheral to the cities, capitalizing upon their proximity, transport links, employment opportunities and access to urban services have grown substantially and even acquired some 'urban characteristics' although they remain outside any institutional arrangement for provision of basic civic services.

Fourthly, ribbons of development along highways, between major urban centres and industrial satellite areas have developed, largely due to accessibility to transport links, availability of skills and services, and tax and tariff incentives. In Karachi, this growth was linked to Nooriabad and Hub. In Lahore, Gujranwala and Sheikhupura, these developed along the Lahore-Gujranwala and Lahore-Sheikhupura roads. Similar developments can also be seen along the other major cities throughout the country. Review of occupational structure show that people residing in rural areas in these districts have a strong occupational interface with the urban areas. A separate, but related, phenomenon is apparent in the more rural context as well, where the population settlement pattern that has emerged shows a very high density of population along the major road corridors. In 1981, one of the least urbanized districts (12.3 per cent urban) of the Punjab, Narowal, had 60 per cent of the population living within 4-km belts along the highways and in the towns. This has enabled easier access to higher level services in urban areas and will possibly play a significant role in the transformation of rural areas to urban.

The cumulative effect of these factors is evident in certain urban districts/divisions. Intense urbanization, connectivity and integration of services and industries across city boundaries and, contiguity of city boundaries have resulted in the emergence of clearly identifiable urban regions. Some of these

urban regions follow the classical pattern where urban systems comprising of peri-urban areas, satellites or small towns have formed around primary cities; Karachi, has an urban system of well over 10 million, and, Hyderabad and Multan with 2.5 million each. In other cases, contiguous districts comprising of major cities, medium sized and small towns, peri-urban areas and ribbons, have formed urban regions. Today the central Punjab urban region–Lahore, Sheikhupura, Faisalabad, Gujranwala districts (and Chiniot tehsil, Jhang district)–have a combined population of 19 million; this alone accounts for over 25% of the provincial population. This system includes three of Punjab's five one-million-plus cities and a number of medium and small towns. Different stages of this phenomenon are apparent in NWFP (Peshawar-Nowshera-Risalpur-Mardan) and in northern Punjab (Rawalpindi-Taxila-Wah).

There is an urgent need to recognize and understand the significance, magnitude and nature of the phenomenon of urbanization. The realization of political rights and participation in the political process; the relationship of, and responsibilities between, the citizen and the state and related institutional structures; the nature of break down of existing societal structures and the forging of new and complex ones; the composition of the revenue base and criteria for resource allocations and, the effect on the nature of poverty, empowerment, gender, governance, culture and marginality–by urbanization–is key to developing an understanding of the political process.

Source: Ali, Reza, 'Underestimating Urbanization', in Zaidi, S. Akbar (ed.), Continuity and Change: Socio-political and Institutional Dynamics in Pakistan (Karachi: City Press, 2003).

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20 The Social Sectors II: MDGs, Gender, Environment, NGOs, Institutions, and Governance

This chapter continues the discussion on the social sectors initiated in Chapter 19. In this chapter we examine the development and role of the Millennium Development Goals, gender, environment, and some other issues. Chapter 21 examines in detail the health sector and the health-poverty nexus in Pakistan, making the strong case that most outcomes and causes in the social sectors are highly inter-linked and inter-connected, especially as the chapter on health—Chapter 21—shows, where the gender question in Pakistan, is linked with maternal mortality, the education of women, the total fertility rate, and a host of other related factors.

20.1 Millennium Development Goals (MDGs)

In the year 2000, at the start of the millennium, 189 developing countries including Pakistan, adopted the Millennium Declaration and pledged to 'spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty', as the central focus of global development efforts for the first 15 years in this new millennium. The Millennium Development Goals (MDGs) are supposed to be the centrepiece of development efforts of the Government of Pakistan, and are meant to be a means to check and assess movement towards targets and goals set as part of the MDGs. Eighteen global targets and 48 indicators were adopted in 2000, which have been translated into sixteen national targets and 37 indicators adopting Pakistan's specific conditions, priorities, data availability and institutional capacity—see Table 20.1 for a list of the MDG targets overall.

Many countries, including Pakistan, have faced serious challenges in the years since 2006, in meeting many of the MDG targets, stemming from a sudden melt-down in the global economy in 2008, along with a sharp rise in oil and food prices earlier that year. Pakistan has been additionally handicapped by many serious political and economic problems, both external and domestic, since 2006/7, and include the consequences of an earthquake, floods, the War on Terror, changes in government from a military dictatorship to democracy, as well as an economic slowdown with GDP growth falling after 2007. It is in light of these social, economic, and political circumstances since 2006, that we examine the progress achieved in reaching the targets set for the Eight MDG Goals, as shown in Tables 20.1 and 20.2 for Pakistan.[1] The most recent status of some of the more important Goals for Pakistan's MDGs, are discussed below.

> In terms of achievements, the Fourth Pakistan *Millennium Development Goals Report 2010*, as Table 20.2 shows, with regard to Goal 1: Eradicating Extreme Poverty and Hunger, stated, that 'with declining economic growth and rising inflation, this has forced the removal of a large number of subsidies, and it is probable that a larger number of people have fallen into poverty, which would have negatively impacted human development and, consequently, the country's ability to achieve the Millennium Development Goals. Targets for the Medium Term Development Framework (MTDF) 2009–10, have not been met in the three indicators for Goal 1, and it does not look likely that the MDG target in 2015, more than halving the poverty target in five years, will be achieved. Low inflation, job creation and high growth are required to help in coming close to achieving the MDG 2015 targets'.[2]
>
> Goal 2, Achieving Universal Primary Education, 'focuses on three core indicators, (a) the net primary enrolment ratio; (b) completion/survival rate from grade 1 to 5; and (c) the literacy rate. The net enrolment at primary level remained below 60 per cent until 2008–09 although there has been marginal improvement in it over time. The MDG target of achieving 100 per cent net enrolment ratio by 2015 requires an increase of 40 percentage point in the next six years compared to the 20 percentage point achieved in the last ten years. The completion/survival rate of students enrolled in primary schools also presents a dismal scenario which implies that almost half of the students enrolled in primary schools do not complete their education. The interim target for 2009–10 was set at 80 per cent and could not be achieved. Pakistan's literacy rate remains considerably short of the MDG target of 88 per cent by 2015, although it had marginally improved to 57 per cent by 2008–09. The rate of increase needs to be more than double for the targets to be achieved. The female literacy rate, especially in rural areas, needs to be accelerated at a much higher rate since the shortfall in it is much higher.'[3] It is clear, that 'there seems to be considerable shortfall in achieving the MDG targets for Goal 2, even if

Table 20.2 Official List of Millennium Development Goals indicators: (All indicators should be disaggregated by gender and urban/rural as far as possible).

Millennium Development Goals (MDGs)	
Goals and Targets (from the Millennium Declaration)	**Indicators for monitoring progress**
Goal 1: Eradicate extreme poverty and hunger	
Target 1.A: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.	1.1 Proportion of population below $1 (PPP) per day[1] 1.2 Poverty gap ratio 1.3 Share of poorest quintile in national consumption
Target 1.B: Achieve full and productive employment and decent work for all, including women and young people.	1.4 Growth rate of GDP per person employed 1.5 Employment-to-population ratio 1.6 Proportion of employed people living below $1 (PPP) per day 1.7 Proportion of own-account and contributing family workers in total employment
Target 1.C: Halve, between 1990 and 2015, the proportion of people who suffer from hunger.	1.8 Prevalence of underweight children under-five years of age 1.9 Proportion of population below minimum level of dietary energy consumption
Goal 2: Achieve universal primary education	
Target 2.A: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.	2.1 Net enrolment ratio in primary education 2.2 Proportion of pupils starting grade 1 who reach last grade of primary 2.3 Literacy rate of 15–24 year-olds, women and men
Goal 3: Promote gender equality and empower women	
Target 3.A: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.	3.1 Ratios of girls to boys in primary, secondary and tertiary education 3.2 Share of women in wage employment in the non-agricultural sector 3.3 Proportion of seats held by women in national parliament
Goal 4: Reduce child mortality	
Target 4.A: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	4.1 Under-five mortality rate 4.2 Infant mortality rate 4.3 Proportion of 1 year-old children immunized against measles
Goal 5: Improve maternal health	
Target 5.A: Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio.	5.1 Maternal mortality ratio 5.2 Proportion of births attended by skilled health personnel
Target 5.B: Achieve, by 2015, universal access to reproductive health.	5.3 Contraceptive prevalence rate 5.4 Adolescent birth rate 5.5 Antenatal care coverage (at least one visit and at least four visits) 5.6 Unmet need for family planning
Goal 6: Combat HIV/AIDS, malaria and other diseases	
Target 6.A: Halve halted by 2015 and begun to reverse the spread of HIV/AIDS.	6.1 HIV prevalence among population aged 15–24 years 6.2 Condom use at last high-risk sex 6.3 Proportion of population aged 15–24 years with comprehensive correct knowledge of HIV/AIDS 6.4 Ratio of school attendance of orphans to school attendance of non-orphans aged 10–14 years
Target 6.B: Achieve, by 2010, universal access to treatment for HIV/AIDS for all those who need it.	6.5 Proportion of population with advanced HIV infection with access to antiretroviral drugs
Target 6.C: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases.	6.6 Incidence and death rates associated with malaria 6.7 Proportion of children under 5 sleeping under insecticide-treated bednets 6.8 Proportion of children under 5 with fever who are treated with appropriate anti-malarial drugs 6.9 Incidence, prevalence and death rates associated with tuberculosis 6.10 Proportion of tuberculosis cases detected and cured under directly observed treatment short course

Contd. on next page...

Table 20.2 contd... **Goals and Targets**	**Indicators for monitoring progress**
Goal 7: Ensure environmental sustainability	
Target 7.A: Integrate the principles of sustainable development into country policies and programmes and reverse the loss of environmental resources. Target 7.B: Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss.	7.1 Proportion of land area covered by forest 7.2 CO_2 emissions, total, per capita and per $1 GDP (PPP) 7.3 Consumption of ozone-depleting substances 7.4 Proportion of fish stocks within safe biological limits 7.5 Proportion of total water resources used 7.6 Proportion of terrestrial and marine areas protected 7.7 Proportion of species threatened with extinction
Target 7.C: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation.	7.8 Proportion of population using an improved drinking water source 7.9 Proportion of population using an improved sanitation facility
Target 7.D: By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers	7.10 Proportion of urban population living in slums[2]
Goal 8: Develop a global partnership for development	
Target 8.A: Develop further an open, rule-based, predictable, non-discriminatory trading and financial system. Includes a commitment to good governance, development and poverty reduction—both nationally and internationally Target 8.B: Address the special needs of the least developed countries. Includes: tariff and quota free access for the least developed countries' exports; enhanced programme of debt relief for heavily indebted poor countries (HIPC) and cancellation of official bilateral debt; and more generous ODA for countries committed to poverty reduction Target 8.C: Address the special needs of landlocked developing countries and small island developing States (through the Programme of Action for the Sustainable Development of Small Island Developing States and the outcome of the twenty-second special session of the General Assembly). Target 8.D: Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term.	*Some of the indicators listed below are monitored separately for the least developed countries (LDCs), Africa, landlocked developing countries and small island developing States.* Official development assistance (ODA) 8.1 Net ODA, total and to the least developed countries, as percentage of OECD/DAC donors' gross national income 8.2 Proportion of total bilateral, sector-allocable ODA of OECD/DAC donors to basic social services (basic education, primary health care, nutrition, safe water, and sanitation) 8.3 Proportion of bilateral official development assistance of OECD/DAC donors that is untied 8.4 ODA received in landlocked developing countries as a proportion of their gross national incomes 8.5 ODA received in small island developing States as a proportion of their gross national incomes Market access 8.6 Proportion of total developed country imports (by value and excluding arms) from developing countries and least developed countries, admitted free of duty 8.7 Average tariffs imposed by developed countries on agricultural products and textiles and clothing from developing countries 8.8 Agricultural support estimate for OECD countries as a percentage of their gross domestic product 8.9 Proportion of ODA provided to help build trade capacity Debt sustainability 8.10 Total number of countries that have reached their HIPC decision points and number that have reached their HIPC completion points (cumulative) 8.11 Debt relief committed under HIPC and MDRI Initiatives 8.12 Debt service as a percentage of exports of goods and services
Target 8.E: In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries	8.13 Proportion of population with access to affordable essential drugs on a sustainable basis
Target 8.F: In cooperation with the private sector, make available the benefits of new technologies, especially information and communications	8.14 Fixed telephone lines per 100 inhabitants 8.15 Mobile cellular subscriptions per 100 inhabitants 8.16 Internet users per 100 inhabitants

The Millennium Development Goals and targets are from the Millennium Declaration, signed by 189 countries, including 147 heads of State and Government, in September 2000 (http://www.un.org/millennium/declaration/ares552e.htm) and from further agreement by member states at the 2005 World Summit (Resolution adopted by the General Assembly - A/RES/60/1, http://www.un.org/Docs/journal/asp/ws.asp?m=A/RES/60/1). The goals and targets are interrelated and should be seen as a whole. They represent a partnership between the developed countries and the developing countries "to create an environment—at the national and global levels alike—which is conducive to development and the elimination of poverty".

1 For monitoring country poverty trends, indicators based on national poverty lines should be used, where available.
2 The actual proportion of people living in slums is measured by a proxy, represented by the urban population living in households with at least one of the four characteristics: (a) lack of access to improved water supply; (b) lack of access to improved sanitation; (c) overcrowding (3 or more persons per room); and (d) dwellings made of non-durable material.

Box 20.1

MDGs 2012 Not Met

As the discussion above shows, the last full Pakistan MDG Report was published in 2010, and since then we only have press statmenets and summaries which evaluate the state of the MDGs. Based on these announcements, it seems that Pakistan is lagging in many of the MDG targets for 2012.

Out of the total 33 indicators, Pakistan's progress on 20 is lagging behind, is slow on four, on track on three, off-track on one, while targets against five have been met, reveals the United Nation's Report on Millennium Development Goals (MDGs) 2012 on Tuesday.

One of the indicators where situation has really worsened in the past four years is the proportion of population below minimum level of dietary energy consumption. This is the core indicator for assessing the level of food insecurity in the country. A number of reasons have contributed to the food insecurity in the country. These include the two-digit inflation (and a much higher food inflation) over the last four years, which has significantly decreased the purchasing power of the people, especially the poor. With 225,450 total estimated annual newborn deaths, each day 618 Pakistani newborns die.

Pakistan's MDGs situation: Pakistan has adopted 18 targets and 41 indicators against which progress is measured. However, time series data against only 33 indicators is available.

Three important targets on poverty, slums and water have been met three years ahead of 2015, says this year's report on the MDGs, launched by UN Secretary-General Ban Ki-moon. Meeting the remaining targets, while challenging, is possible but only if governments do not waiver from their commitments made over a decade ago.

The MDG 1: Eradicate extreme poverty and hunger. MDG 2: Achieve universal primary education. MDG 3: Gender equality and women empowerment. MDG 4: Reduce child mortality. MDG 5: Improve maternal health. MDG 6: Combat HIV/AIDS, malaria and other diseases. MDG 7: Ensure environmental sustainability. MDG 8: Develop a global partnership for development.

MDGs achieved: On a total of five indicators, Pakistan is either ahead or has achieved the target. With regard to access to improved water source, Pakistan has achieved the target when three sources of improved water are taken into account: tap water, hand pumps and electric motor propelled water. However, the Pakistan MDG report 2010 has not included the 'electric motor' in the category of improved water source, which makes the status at around 63 per cent against the 92 per cent (if water extracted through electric motor is included). Pakistan has one of the highest ratios of women parliamentarians in the South Asia Region.

MDGs on track: There are three indicators—one each for MDG 4, 6 and 7—where the progress is on track and the target could be met by 2015.

Slow progress on MDGs: Following are the indicators where there has been some progress but the progress rate is slow. Additional efforts will be needed if the targets, in this category of indicators, are to be achieved by the 2015 deadline. It can be noted that three out of the four indicators on which progress is slow, are related to MDG 3 (gender equality and women empowerment). The remaining one relates to MDG 6: Combat HIV/AIDS malaria and other diseases.

MDGs lagging behind: This is the category of indicators where progress has been lagging behind and target, most likely, will not be achieved. Progress against a few indicators under this category has been unidirectional. The head count poverty (caloric plus basic needs) in Pakistan has been fluctuating. It increased from 26 per cent (baseline in 1990) to 34 per cent in 2000–01 before declining to 22.3 per cent in 2005–06. In terms of $1.25 per day, according to World Bank, 21 per cent of the populations were living below this threshold in 2007–08 against a target of 22.8 per cent by 2015. So if this yardstick is used, then Pakistan has already achieved the target.

Off-track MDGs: The following is the only indicator where the government of Pakistan has reported progress as 'off the track'. This relates to the reduction in child mortality. At current in Pakistan, the number of deaths of children under one year of age per 1,000 live births is 75 against the target of 40.

The IMR situation in Pakistan has not improved because the highest proportion of IMR is of neonatal mortality and the neonatal mortality in Pakistan is increasing. According to UNICEF's situation analysis of children and women in Pakistan, 'In 2009, Pakistan accounted for 6.9 per cent of global newborn deaths and ranked third from the bottom (at 191 out of 193 countries) in terms of the number of newborn deaths. The neonatal mortality rate has actually increased, from 49 per thousand live births in 2000–01 to 53 per thousand in 2007–08. With 225,450 total estimated annual newborn deaths, each day 618 Pakistani newborns die.'

Issues and constraints—summing up: A number of factors have contributed to the under-achievement against most of the MDGs. These include the slow economic growth of less than 3.0 per cent over the last three to four years. With a labour force increasing at a rate of 3.2 per cent, the slow economic growth is not creating sufficient jobs for the new entrants to the labour market. Besides poverty and unemployment issues, the income inequality in the country has always been on the rise. The share of consumption of the lowest quintile is currently 9.6 per cent against 40.3 per cent for the highest quintile. There also exists widespread gender inequalities. The share of women in wage employment is the slowest in South Asia and Pakistan is not an exception to it. Additionally there are regional pockets where status of development is worse than other areas. Notwithstanding these challenges, there are a number of opportunities to build on. The New Economic Growth Framework shows the government's priority to put Pakistan on the path of sustained economic growth. The increase in the share of provinces in National Finance Commission Award and the 18th Constitutional Amendment for the decentralization of governance at the provincial level will help the development partners to work more closely with the end beneficiaries.

Source: *The Daily Times*, Lahore, 4 July 2012

> access to basic services, and on a pervasive gender bias in the access to economic resources which is the source of a severe intra-sex and intra-household income inequality. Women are married at an early age, have shorter lives, work longer hours, remain mostly illiterate, and have minimal opportunities for schooling, training and gainful employment. Their low/secondary status precludes any significant decision-making even in fertility control.[9]

Table 20.3 highlights the problem and reinforces the evidence that 'on virtually every socio-economic indicator, Pakistani women fare worse than their South Asian counterparts and worse than women in other low income countries'.[10] Although, as we show below, many things regarding the status of women in Pakistan are changing, the following observations can still be made about the status of women in Pakistan.[11]

1. Pakistan had the lowest sex ratio in the world: in 1985 there were 91 women for every 100 men, down from 93 in 1965.
2. Life expectancy at birth for women was lower than for men in Pakistan, making it one of only four countries in the world where men live longer than women.
3. Primary school enrolment rates for girls are among the ten lowest in the world.
4. While the incidence of ill-health and premature death among the poor of both sexes is very high in Pakistan, women and girls are worst affected.
5. Pakistan's maternal mortality rate was the highest in South Asia and greater than that in other Muslim countries, essentially due to birth-related problems. This is compounded by the very high prevalence of babies with low birth-weight—only three countries in the world had a higher percentage of such babies than Pakistan.
6. Only 29 per cent of the labour force was constituted by women, below the 33 per cent average for South Asian countries.

Table 20.3
Key Indicators Showing Women's Status in Pakistan and South Asia

	Pakistan	South Asia weighted average
Population as % of total population	46	48
Literacy rate (%)	25	37
– as % of males	48	81
Primary net enrolment rate (%)	62	70
Labour force as % of total labour force	29	33
Adult female economic activity rate (as % of male)	40.3	52.4
Life expectancy rate	62.59	63.2
– as % of male	99	105
Gender-related development index (GDI) 1997	0.472	0.511
2000	0.468	0.634
Gender-empowerment measure (GEM) 1997	0.176	0.236
Female real GDP per capita (PPP $)	701	874
– as % of male	29.7	39.3
Female percentage of out-of-school children at primary level	54	59

Source: Mahbub ul Haq, Human Development Centre, *Human Development in South Asia 2000: The Gender Question* (Karachi: Oxford University Press, 2000), and Mahbub ul Haq, Human Development Centre, *Human Development in South Asia 2002, Agriculture and Rural Development* (Karachi: Oxford University Press, 2003).

Table 20.3 also shows very clearly, *that on every single account*, women in Pakistan had a far worse economic and social status, not just compared to men within the country, but also compared to women in the rest of South Asia. What is more worrisome, is the fact that in terms of the Gender-related Development Index (GDI) things were getting far worse. In 1997, the GDI for Pakistan was 0.472, which *fell* to 0.468 in 2000. At the same time, for South Asia as a whole the GDI—which is a measure similar to the Human Development Index (HDI) except that it adjusts the HDI for gender equality in life expectancy, educational attainment and income—had improved. This shows that while the social and economic position of women in Pakistan had not just deteriorated, the Pakistani woman was being left far behind the other women of South Asia.

20.2.2 Some Issues[12]

The social and economic benefits of educating girls and women are very significant, and there is a plethora of evidence that supports this finding[13]—see Table 20.4. Mothers' education favourably impacts on children; educated mothers increase the effectiveness of public health services

Table 20.4
Educating Women

Fertility Rates and Educational Attainment of Married Women

	Illiterate	Primary	Secondary	Tertiary
Urban	5.09	4.48	3.57	3.12
Rural	4.63	4.00	3.21	3.23

Infant Mortality Rates

No Education 89; Below Primary 80; Below Secondary 61; Secondary and above 49.

Immunization of Children Under Five (Fully Immunized, %)

No Schooling 10; Primary 16; Secondary 21; Higher Secondary 26.

Source: Social Policy and Development Centre, *Annual Review 2002–03: The State of Education* (Karachi: SPDC, 2003).

and substitute for them when they are not available. There are higher survival rates amongst children of educated mothers, and such children are better nourished and often better educated as well. Moreover, educated women want to have fewer children and are more likely to use contraceptives than uneducated women.[14] The cliché that if you educate a woman, you educate not just her family but the entire nation is, indeed, very true.

There are supply and demand factors that explain why female education is low in underdeveloped countries, and Pakistan is no exception. The 'prevailing culture which values women's reproductive capacities much more than their productive ones, inhibits investments in education'.[15] Early marriages, lack of opportunity for women in the labour force, segregation between the sexes, and travelling long distances to schools also hamper girls' education. Moreover, girls provide critical household help in assisting mothers in childcare, cooking, and fetching water and fuel wood, and hence the opportunity cost of going to school may at times be very high.

Despite these numerous constraints on demand for education amongst girls and women, it is clear that much has been changing in Pakistan and that, due to greater urbanization and modernization, demand for education is growing. Incomes have gone up, and with higher incomes, the desire and affordability of education, even for girls, rises. There is a perceived need to educate girls, as it is recognized, especially in urban areas, that there are financial returns to education. Not only can educated girls get a job and supplement the household's income, but the family realizes that educated girls fetch better suitors, and hence can marry into a better social class. In addition, better transport and communications have made it easier for girls to go to school, and mass media campaigns have also been helpful. Stereotypes on television, which is now widely viewed even across remote areas, show girls and women as educated. Traditional values and mores have also undergone considerable change, and female seclusion, while still practised, has decreased—see Box 20.2.

While demand may have increased, supply constraints have adversely affected female education. The World Bank study correctly identified a key cause of low female literacy and education: 'a shortage of female teachers is the single most important constraint to raising enrolments at the primary level, especially in rural areas. Apart from the low public expenditure which has created a shortage of girls schools and female teachers, hiring and retaining female teachers in rural areas is difficult.'[16] While there had been greater emphasis in recent years on girls' education, essentially due to the Social Action Programme, the situation is still far from satisfactory.

In the case of health care, high fertility rates and closely spaced and frequent pregnancies are the most serious cause of high maternal mortality and morbidity. Furthermore, according to the World Bank report on Pakistani women,

> these are compounded by inadequate nutrition (especially during pregnancy and breast feeding), lack of clean water and sanitation facilities, women's economic and domestic workload and the health care system's inability to meet women's health needs. Poverty and *purdah* prevent many women from getting access to the few health facilities that cater to them. Cultural norms often prevent consultation with male doctors and health staff when female staff are not available, which further compounds problems.[17]

Since educating women has beneficial effects on the household, by training and educating women about basic health and medical issues, the rest of the family, particularly children, benefit. Better hygiene, sanitation, and nutritional practices may emerge if women are taught about basic diseases—by any means a very cost effective method of reducing health problems.

Moreover, women have found a strong voice in the public and political arena since 2000 under General Musharraf's District Government system. Although currently Pakistan does not have an elected local government system, Afiya S. Zia and S. Akbar Zaidi point out the huge impact, even if for only eight years, the elected District Government system had on women. They argue:

> The main consequence of former Gen. Musharraf's devolution system has undoubtedly been the extraordinary entrance of women as elected and nominated public representatives at the lowest tier of government. With 33 per cent reserved seats for women at all levels in the devolution system, 36,066 women councillors were elected and nominated in the first round of local government elections in 2001. With the size of the councils reduced in 2005, but still with the 33 per cent reserved seats for women, 24,528 women were elected to serve the public through the local government system. In a society considered 'tribal', backward, conservative and much worse, this entry of women as public representatives must stand out as the most important outcome of the devolution reforms undertaken in Pakistan.
>
> While cynics always point out that women in Pakistan are largely tools in the hands of their menfolk, one cannot be oblivious to the impact the public presence of thousands of women had on their, and their communities' lives.[18]

20.2.3 Finding Some Options

Although Appendix 20.1 provides a very different (in fact, radical) examination of the causes and implications of discrimination against women, some standard suggestions that may help on the margin can also be made. In terms of involvement in unremunerated work, paid employment, education, and in numerous other ways, the key to well-being rests on the development of the potential of women, as part of the family and as individuals. While there have been attempts at affirmative action to redress the balance in the past, much has been left wanting. Indeed, one of the reasons why social development has been poor is the lack of development specific to women.

The attempts on the part of various governments to inform men and women about the rights of women is a very positive first step towards empowering women. Publicity campaigns about domestic violence and the rights of women, and on gender discrimination, along with measures such as the initiation of separate police stations for women, will help in building awareness and also in rectifying injustices. Other programmes, such as the Prime Minister's programme of employment for women, especially in the health and education sectors, are welcome developments. Moreover, continued legislation to eliminate social injustices towards women, and to enhance their status, should be encouraged. The measure to increase women's seats in Parliament and to reserve 33 per cent seats in local (district) government, is a radical and bold measure which has allowed women far greater participation in public life. Setting up the National Commission on the Status of Women (NCSW) and other forums where issues specific to women and to society are discussed—and possibly redressed—are welcome initiatives as well.

In rural areas, women do not have many independent opportunities to find paid work, and their role revolves around doing unpaid work for the family. This includes tending to livestock, getting wood for fuel, collecting water, working on agricultural land, and a host of other economic and household-related activities. However, experiences from rural areas as diverse as those in Bangladesh and the northern areas of Pakistan have shown that, given the right opportunities and incentives, women can set up income-earning projects and supplement the family's income. Moreover, this small step of independence will become a big step towards empowerment and emancipation.

A critical factor in promoting enterprise by women is the availability of credit. In rural areas, women avail credit to buy livestock or poultry, which often produces a small marketable surplus. In urban areas, the use of credit by women is more diverse, as the money can be used to develop home schools or some small enterprise based in the home. So far, most of the credit available to women to set up small-scale projects has come from non-governmental organizations (NGOs) or from international donors, while the government has not been an active player in this area. It is necessary to focus on the means by which credit can be made readily available to women in rural and urban areas. Different mechanisms for delivery and accountability can be developed to ensure repayment. NGOs and the government can work closely together to achieve these goals. In order to expand the outreach of credit availability, the First Women's Bank should expand and enlarge its branches across the country. Moreover, attempts should be made to develop a system of Mobile Field Officers, who can provide credit to women who are unable to come to the larger cities.

One of the most consistent and least controversial findings from the social sciences relates to the huge benefits that accrue from female education and literacy. No efforts should be spared in developing opportunities and facilities that help in promoting these aims. While school-going girls can acquire some formal literacy and education, an older generation has not been able to make use of the recently expanding opportunities to acquire formal education. Here, local, community-based organizations can fulfil an important role and provide the non-school-going female population with basic education, and teach nutrition, and health skills, by setting up classes at a mohalla level for women who stay at, or near, their homes. Nevertheless, one must emphasize the fact that the issues of discrimination which confront women in all spheres of the economy are based on structural, historical, and ingrained factors in society. One cannot achieve much success, no matter how well intentioned, unless the structural causes of discrimination are addressed (see Appendix 20.1). Moreover, there is an urgent need to repeal all anti-women and discriminatory laws such as the Hudood Ordinances, the Law of Evidence, the Qisas and Diyat Laws, as well as enforce new laws on karo-kari and honour killings and, importantly on rape, domestic violence, and sexual harassment. See also Box 20.3 for how women's development in Pakistan has been modelled into a religious/ Islamic context by prominent and generous donors, where the women's question is being framed not in light of women as individuals, but women as Muslims.

20.3 The Environment[19]

While Pakistan's population is a little over 2 per cent of the entire world's population, its energy consumption was a mere 0.29 per cent, i.e. less than even half of one per cent. This is not a surprising statistic, as much of the energy consumption takes place in the developed western nations of the globe, and while the majority of the population lives in underdeveloped countries, it is the minority, developed countries, that consume much more energy. The low-income countries use energy of about 353 kg (oil equivalent) per capita, while the corresponding figure for high-income economies is 5,245 kg per capita. Pakistan's energy use of 209 kg per capita was well below the low-income country average, and lower than that for India (242). While Pakistan's energy use was lower than that of comparable countries, its average annual growth rate of 6.8 per cent between 1980 and the 1990s, was higher than the average for low-income economies (5.4 per cent growth), and was amongst the highest for this category.[20]

Table 20.5 shows that Pakistan's energy consumption per capita of 7.42 gigajoules was about one-eighth as much energy as was used globally per capita. Each Pakistani contributed 0.1 tonnes of carbon to the atmosphere, which was about one-twentieth of the per capita average contribution globally. Carbon monoxide emissions per capita were one-third of the global average, with the entire country providing less than 1 per cent of the globe's share.

Pakistan's deforestation was a minuscule proportion of the deforestation taking place at a global level, and the rate at which it was taking place in Pakistan was much slower than the world rate of deforestation (see also Box 20.4). The rate of loss of tropical forests was one-third as rapid as the global rate. Similarly, the loss of topsoil was also far slower than the world average. The IUCN report, in its evaluation of Pakistan's contribution to environmental problems, argued that 'it is clear that Pakistan is neither a major global polluter nor a large consumer of resources. In fact, it has a

Box 20.2

Progress Made by Women in Pakistan

Shahid Javed Burki writes about how women in Pakistan have begun to make their presence felt in the job market and the public sphere in Pakistan.

The term 'a quiet revolution' sounds like an oxymoron, since revolutions normally produce a lot of noise. But when something entirely unexpected happens that, too, can be called a revolutionary event even if it is not noisy. That is precisely what women in Pakistan are experiencing. A significant number of them are leaving their homes and entering the workforce. The numbers involved are large enough to make a difference not only to the women's overall welfare, but it will profoundly affect the way Pakistani society will function, the way its economy will run and the manner in which its political order will evolve. This change is coming about as a result of development in three major areas: education, employment, and entrepreneurship.

Let us begin with education. There is a widespread belief that women are faring poorly in receiving education. That impression is correct to some extent. The overall rate of literacy for women is low; much less than that for men which is also not very high. Although the Government of Pakistan is a signatory to the Millennium Development Goals (MDG), the country is far from achieving them. Attaining universal literacy for both boys and girls by the year 2015 was one of the MDGs. With literacy rates standing at 70 per cent for boys and only 45 per cent for girls in 2010, Pakistan will miss these goals by a vast margin.

However, when speaking of a revolution, the reference is to the growth rate in women's enrolments in institutions of higher learning. Here, the recent trends are extraordinary—in fact revolutionary. It is interesting and puzzling that some of the numbers used here to make this point have not appeared in the country's discourse about economic and social issues. Over the last 17 years, from 1993 to 2010, the number of girls enrolled in primary education has increased from 3.7 million to 8.3 million. This implies a growth rate of 6.7 per cent a year, about two and half times the rate of increase in the number of girls entering the primary school-going cohort. However, even with this impressive rate of increase, it is worrying that girls still account for less than one half—the proportion was 44.3 per cent in 2010—of the total number of children in school.

It is in higher education that girls have made a most spectacular advance. The numbers of girls attending what are described as 'professional colleges' has increased in the same 17-year period, at a rate of eight per cent per annum. In 1993, there were only 100,400 girls attending these institutions. Their number increased to more than 261,000 in 2010. There are now more girls in these institutions than boys. Their proportion in the total population of these colleges has increased from 36 per cent to 57 per cent in this period.

It is attendance in the universities, though where the real revolution has occurred. There were less than 15,000 girls in these institutions in 1993; their number increased to 436,000 in 2010. The proportion of girls is approaching the 50 per cent mark with the rate of growth in their numbers an impressive 28 per cent a year. While a very large number of girls drop out between the primary stage and the stage of professional and university education, the numbers completing higher education is now much greater. Three quarter of a million girls are now leaving the institutions of higher learning every year.

In education, it is the numbers that make a revolution. Given the rate of increase in the number of girls attending these institutions, it is not an exaggeration to suggest that by 2015 a million girls will be ready every year to enter the modern sectors of the economy. That has already begun to happen and here the statistics on participation in the workforce don't tell the complete story. Official statistics still indicate very low levels of women's participation in the workforce. According to the official data, only 16 per cent of women were working compared to 50 per cent of men. The rate of women's participation in the workforce is higher in the countryside than in urban areas—19 per cent as against eight per cent. But these statistics don't paint the real picture. A lot of the work that women do, either in the households or in the work place, does not get recorded. This is not only the case for developing countries. The same happens in more developed economies that keep a better record of what people do for living. In Pakistan, for instance, women are very actively engaged in the livestock sector but that goes mostly unnoticed in official accounting.

There are a number of sectors in modern areas of the economy where women now make up a significant part of the workforce. These include the traditional areas where educated women have been active for decades. These include teaching and medicine. However, more recently, as the number of women with high levels of skills increased, they have become players in sectors such as banking, communications, law, and politics. Women also now make up a significant proportion of the workforce in companies engaged in IT work. Some IT experts have estimated that in their sector, there are tens of thousands of women working in what they call 'cottage businesses'. These are women with good computer skills, who are working from their homes undertaking small contractual work for members of their families or their friends who are living and working abroad. Some estimates suggest that more than a billion dollars worth of work gets done in these informal establishments. These are, by large, one-person shops that receive payments through informal transactions. However, it is the entry of women in the entrepreneurial field where the real revolution is occurring. I will take up that subject in this space next week.

Source: Burki, Shahid Javed, 'A Quiet Revolution by Women in Pakistan', *Express Tribune*, Karachi, 2 July 2012.

In another article, Shahid Javed Burki continues the same theme, and shows that 'it is in education that the Pakistani women have made the most spectacular advance in the country'.

It is in education that the Pakistani women have made the most spectacular advance in the country. The change noted above has come about for the reasons that are not unique to Pakistan. It is happening in other parts of South Asia as well.

The state was failing to get the public sector to deliver the quality of education demanded by parents belonging to the middle class. As the demand for spaces within the educational system increased, the state came under growing pressures. More financial and human resources were required to take in all the students knocking at the doors of the system. Most South Asian states did not have the funds in the amounts needed, qualified teachers in the numbers desired, and textbooks of the quality parents demanded should be used to teach their children. One conclusion that was drawn was that the availability of finance in the needed amount would reform public education. This turned out to be the wrong assumption to make.

That additional finance alone won't solve the problem was vividly illustrated by the embarrassment caused to the World Bank by the spectacular failure of its large social action programme, or SAP, in Pakistan. This multi-donor, multibillion dollar program was aimed at giving a major lift to the educational sector in the country by increasing the rate of enrollment for both boys and girls, by building new schools in the rural areas so that children didn't have to walk long distances to attend classes, to provide better trained teachers, and to improve the quality of instruction by using better textbooks. The program's intentions were good but the reason for its almost total failure was its implementation.

In the initial stages, the programme concentrated on the province of Punjab. The education department in Lahore, the provincial capital, had a poor reputation. It was under the influence of the political forces that put pressure on its officials to employ their friends and relatives or to move those who were already working in the system to more desirable places. To use a jargon of the time, the provincial education department was focusing on 'postings and transfers' of teachers as its principal function. An enormous growth in the availability of funds in the system because of the resources provided by the SAP led to a sharp rise in the level of departmental corruption which was already high. The program because of these design failures was eventually abandoned by the Bank and other members of the donor community.

However, failed efforts such as these created an opportunity for women with good education, with access to family funds, and with children of their own to step in and establish institutions which they would manage themselves. Their own children and the children of their friends and relatives were their first batch of students. Mona Kasuri from a well-established political and business family was one of the pioneers in this area in Pakistan and her performance is an excellent example of the marriage of entrepreneurship to the availability of opportunity.

Some of the more impressive school systems in Pakistan started modestly with the founding-mother creating a facility over which she could watch as her own children were being taught. Some of these ventures were begun in the homes of the budding education-entrepreneurs. These modest institutions grew from the pre-school and kindergarten stage to the primary stage and to the high school stage. In one case—in the case of the school started by Mrs Kasuri—its development took it to the university stage. The Beaconhouse school system is said to be one of the world's largest: having received an infusion of a significant amount of foreign capital provided by a private equity fund it has gone beyond Pakistan's borders and established—in some cases acquired—school systems in Africa, the Far East, and Britain. The owners of this for-profit educational system have ploughed back some of their accumulated earnings by giving a large donation for the establishment of a liberal arts university called Beaconhouse National University. BNU, specializing in liberal arts, has concentrated on the subjects that attracted women and for which there were growing markets. It is providing instruction in communications, IT, visual arts, architecture, and economics.

This one example provides a good illustration of how women's advanced education and acquisition of modern skills have begun to change the social and political landscape. Well qualified women with right kinds of skills have decided not to stay at home and build and care for their families. They are increasingly becoming professionals and occupying high level positions. Some economists maintain that supply creates its own demand and that has indeed happened in the case of Pakistan with some significant changes in public policy. For several decades after independence, Pakistan did not admit women into what were called the 'superior services'. These included the Civil Service of Pakistan and the Pakistan Foreign Service. That ban on the recruitment of women was lifted a couple of decades ago and now women have advanced to the senior most echelons in both services. According to a paper written recently by a female diplomat, there are now more than a dozen women serving as ambassadors around the globe.

It is, therefore, fair to conclude that even in a country which is presently in a severe depressed condition, women's educational and work performance may offer one hope for a better future. By relegating women for so long to the back benches, Pakistan was operating its economy with one hand tied to back. That hand has now been loosened and may contribute to the country's revival.

Burki, Shahid Javed, 'Changing the Landscape', *Express Tribune*, Karachi, 8 July 2012.

Box 20.3

Women's Development, NGOs, Donors, and Islam

Afiya Shehrbano Zia examines the interplay between donor funding, NGOs, academics and Islam in the context of women's development in Pakistan after 9/11.

Collaboration between western academia and Pakistani women at home and in the diaspora has established a body of donor-funded research with an exclusive focus on Islam. Will development policies based on such research lead to any kind of liberation?

Recourse to religion and a focus on faith-based organizations as a point of entry for development initiatives has gained momentum in recent years, with serious implications for women's rights. The case of Pakistan provides ample illustration of these trends. In the 1980s, several women's research and advocacy groups, such as Women Living under Muslim Laws, engaged with Islamic frameworks to pursue a gender equality agenda. When post 9–11 propaganda targeted 'oppressed Muslim women' with blatant hypocrisy, this led to an academic turn in the direction of exploring, rescuing, and in some cases reinventing the agency of veiled Muslim women, even in cases that signified pietistic acceptance of discrimination.

This new scholarship has matured into a full-blown project to challenge and reject the viability of universal, liberal, and indigenous secular feminist possibilities in Muslim-majority countries as culturally inappropriate. This thinking permeates tangible development policies and projects across Pakistan, as a celebrated confirmation of the pragmatic possibilities of development subsumed and framed by religion. Ironically, the policy-directed research espousing this framework is often shaped and directed by priorities and actors—such as foreign consultants or academics—removed from the collective developmental, political or activist paradigms of the country itself. Pakistani development activists and feminists who act as subcontractors for these projects may find themselves in a bind, projecting a secular political identity whilst engaging in donor-funded development projects that reinforce the communitarian logic of religion.

Three examples of the policy direction of Anglo-American international development agencies, particularly DFID and USAID, highlight the new directions of 'donor-driven Islam'—development assistance that introduces a creeping theocratization of formerly rights-based approaches to gender.

In 2007, USAID completed a project in Pakistan called *Respecting the Veil.* The purpose was to enable the financial empowerment of home-bound women while respecting their 'veil'. The project comprised husband and wife teams. While the wives liaised with women embroiderers, husbands dealt with wholesalers and markets. The framework of this project can be explained by its acronym, AWESOME (Association of Women Entrepreneurs in Small and Micro Enterprise). The 'success' indicators were the sales projections of USAID whereby the estimated incomes for rural embroiderers would rise to Rs. 1600 per month by 2010 (the government-declared minimum wage in 2008 was Rs. 6000 per month). The subcontractors—the husbands—were strengthened at the expense of the embroiderers themselves who received well below the minimum wage, while the power relations in husband-wife partnerships remained unaddressed and traditions such as the veil were upheld instead of developing or improving the market conditions for women's mobility. The informal sector was further entrenched under the banner of cultural/religious sensitivity.

The UK Department for International Development (DFID) took a more inclusive approach in its development initiative in the North Western Frontier Province of Pakistan during the rule of the religious political alliance, the Mutahida Majlis-e-Amal (MMA). As neophytes of electoral victory in 2003, the MMA government in the NWFP imposed Shari'a legislation, attempted to legalize gender apartheid, prevented women from voting in elections and even banned female mannequins. Women's shelters and NGOs were shut down, accused of being western-influenced mavericks. Nonetheless, the MMA government accepted funding from DFID/Asian Development Bank/World Bank on broader development projects to shake off its own fundamentalist image. However, it refused to negotiate on gender and development initiatives. This was a bargain acceptable to DFID.

Ironically, it is commonly recognized that the MMA suffered subsequent electoral defeat due to the failed or limited progress in achieving development objectives. Thus DFID assisted the religious party in the name of development while the MMA was reversing women's rights, a compromise that was a clear failure in view of the electoral judgment that followed.

The Religions and Development Research Programme (RaD) funded by DFID and carried out by the Universities of Birmingham and Bath in the UK in collaboration with the Lahore University of Management Sciences (Pakistan) has produced a number of Policy Briefs. A background paper on madrasah (religious seminaries) reform in Pakistan, like many others that inform the policy briefs, contains some contradictory and problematic suggestions. The brief advocates for 'support' rather than reform of madrasahs. To my knowledge, there are no development or activist groups in Pakistan who agree with or are committed to this suggestion. The brief goes on to say that, 'The State must win the trust of religious communities'. Given that the state has failed to win the trust of secular or any other communities for that matter, it is unclear why it should concentrate on religious communities. In fact, religio-political entities are the least trusted by the people if electoral performance is anything to go by. The electoral victory of the MMA in 2002 was widely discredited as being the result of the bargain struck between the religious alliance and the army chief General Pervaiz Musharraf who had led a military coup and overthrown the democratically elected government in 1999. Apart from atrophying the two largest democratic parties by sending their leaders into exile and jailing many others, General Musharraf recognized the madrasah—awarded degrees of the MMA members as acceptable prerequisites for contesting general elections. In return, the MMA did not challenge the legal cover extended by the Supreme Court to allow the army chief to contest subsequent presidential elections. These contrived and unusual circumstances allowed

the first ever electoral success of a religious party in the country, commanding enough votes to form the provincial government in the NWFP (now Khyber Pukhtunkhwa).

The policy brief goes on to suggest that reform should be funded by the government's educational budget since the Ulema doesn't trust western donors. Ulema is a vague umbrella term for an imagined clergy which has no constitutional nor democratic legitimacy. The Council of Islamic Ideology (CII) is a constitutional government department that works in an advisory capacity only and with appointments made by the government. The CII does not represent clergymen nor madrassa clergy. Its members are not roving Ulema (although they are scholars of Islam) and there is, therefore, no specific legal entity known as 'the Ulema'. The CII has actively condemned violent and extremist politics by madrassas and their students. Upon consideration, most progressive groups would welcome this streamlining since it is well known that many madaris are covertly funded by Saudi sources and promote hard line Wahabist agendas. Therefore, to be financially dependent upon, and thus exclusively accountable to, the Government of Pakistan would be a fitting recommendation in principle. Except that, the same policy brief goes on to contradict itself by proposing that foreign donors should consider direct funding to the education boards of religious schools. These Wafaqs (education boards representing the different schools of Islamic jurisprudence) are the most conservative, exclusionary bodies and are dominated, to the point of being held hostage, by certain sects depending on the political patronage they receive from provincial governments.

Furthermore, the DFID policy brief ignores the discriminatory history and adverse effects of the Islamization of mainstream education in Pakistan: the long-term, detrimental impact of such educational policies have been well documented. This is even more paradoxical since development agencies such as DFID have historically supported projects to purge religious-discriminatory content from mainstream curricula and helped to reform textbooks.

Other policy papers within the ambit of this DFID project, relate to a research study on Faith Based Organizations in Pakistan. This study concludes that FBOs may or may not be vehicles for equitable development. The study insists its purpose was not to promote a greater or lesser role for religion in achieving development, and that its findings were primarily meant to 'benefit poor people in developing countries'. However, in the research findings quoted, there is no evidence supporting poverty-reduction objectives. If anything, the widespread practice of contracting the assistance of local religious leaders for distributing contraception and for other gender-related projects has resulted in the empowerment of a traditionally discredited local clergy. In Balochistan, in an interview with the author, development activists agreed that these amounted to 'Rent-A-Maulvi' projects.

The trouble is that such initiatives end up legitimising conservatism with the added complication that, very often, FBOs use secular rather than faith-based strategies to meet their parochial ends. So how are faith-based organizations defined as such in the first place?

The value of research per se is not at issue here. However, when research begins to morph into projects targeting institutions, or into developmental or educational joint ventures between western governments and home institutions, it presents a danger. There is no internal consensus within Muslim majority countries regarding a singular or even dominant religious or political identity. Muslim women, including feminists, face very different identity issues in the West when compared to Pakistan. Therefore, the strategies that may work for them within a pluralist, secular state such as the UK have very different implications when transposed to Islamic republics such as Pakistan. Thus when Pakistani feminist researchers become implicated in projects that foreground religion in their home contexts, the secular indigenous possibilities and spaces become more vulnerable, and the results become self-defeating.

The contest of political identities has to be fought between and amongst the radical and moderate, the conservative and liberal, the religious and secular. These categories do not have fixed meanings or expressions and are not necessarily binary alternatives, but what is certain is that more often than not these hold different connotations in diverse cultural contexts. In this respect, scholarship that is critical of Euro-Atlantic feminism is valuable, until it begins to claim religious identity as an immutable, valuable cultural resource to replace secular feminist goals, or more minimally, a neutral or equitable development agenda. When Pakistani liberal, secular feminists become implicated in such projects they gloss over the potential conflict between their political and careerist agendas.

To some extent the growing academic interest in Islam is useful and may even help to boost the careers of some academics/consultants who have jumped onto this bandwagon. But it should not divert us from the very real political challenge presented by localised analysis, debate, contestation, understanding, and struggle. No academic consultant can engage on all these levels.

The complex realities of the ways in which religious identities play out in Muslim majority countries often bear little resemblance to the findings of the academic exercises mentioned above. Such research needs more rigorous scrutiny not just in terms of its methodology but also of its politics, before it starts informing policy and, more worryingly, starts to shape development interventions.

Source: Zia, Afiya Shehrbano, 'Donor-driven Islam?', *Open Democracy*, 21 January 2011. http://www.opendemocracy.net/5050/afiya-shehrbano-zia/donor-driven-islam

Table 20.5
Resource Base and Degradation: World and Pakistan: Late 1980s

Resource	World	Pakistan	Pakistan's share of global (%)	Ratio of Pakistan to global
Land area (million hectares)	13,079	88.2	0.67	–
Population (millions)	51,624	109.7	2.12	–
Population density, 1989 (per 1000 hectares)	389	1,541	–	4
Projected population increase, 1990–2000 (millions)	1,000	40	4	–
GNP per capita, 1987 (US$)	3,100	350		1/9
Energy consumption (petajoules)	282,924	814	0.29	
Energy per capita (gigajoules/capita)	55	7.42		2/15
Increase in atmospheric concentrations of greenhouse gases (million tonnes of carbon)	5,900	15	0.25	
Per capita addition to CO_2 flux (tonnes)	1.7	0.1	–	1/7
Carbon monoxide emissions (million tonnes/year)	193.5	1.53	0.79	1/3
Per capita	0.037	0.013		
SO_2 emissions (million tonnes/year)	155	0.632	0.4	1/5
Per capita	0.03	0.0058		1/5
Per capita additions to methane flux (tonnes)	0.05	0.03	–	2/3
CFC production per capita, 1986 (kilograms)	0.2	0	–	–
Forest area (million hectares)	4,081.50	4.58	0.11	
Deforestation (hectares/year)	20 million	7,000–9,000	0.082	
Annual rate of deforestation (%)	0.48	0.15–0.197		1/3
Topsoil loss (million tonnes)	26,000	47	0.181	
Soil loss (tonnes/hectares)	1.988	0.53		1/4
Crop land (million hectares)	1.475	20.4	1.4	
Expenditure on pesticides (US$ m/year)	18,500	100	0.54	–
Annual pesticide expenditure per hectare crop land (US$/hectare)	12.54	4.9	–	2/5
Average annual marine catch (thousand tonnes)	–	78,955.2	333.7	0.42
Per capita annual catch (kilograms/capita/year)	14	2.8	–	1/5

Source: IUCN, *The Pakistan National Conservation Strategy* (Karachi: IUCN, 1992), 10–11.

considerable unutilized quota of both the productive and assimilative capacities of global systems, insofar as such utilization is sustainable.'[21] However, as Table 20.6 shows, this is no reason for complacency, and there has been a deterioration in important environment-related indicators. Pakistan has less land under National Parks and is losing area under Forest Cover. The extent of desertification in particular, has been severe, with more than half of Pakistan's land lost to desertification.

Table 20.7 and Figure 20.1 show the distribution of Pakistan's nine land capability classes. Cultivable land of different grades capable of growing crops (classes I–IV) constitute only 21 per cent of total area; about a quarter of the available land is considered to be of 'very good' quality, while poor quality available land, fit for a few crops only, constituted about 15 per cent. Good-quality forests and farmland were a minuscule proportion of all the land in Pakistan. Class VIII was 'not capable of growing trees, shrubs or grasses either because of a total absence of soils or because the soils that do exist cannot support productive plant growth'.[22] And as Table 20.6 shows, things are getting appreciably worse.

Overall, agricultural land that was being used in Pakistan was being used at below its productive capacity, resulting in less than potential output. The factors that affect land productivity included water erosion, wind erosion, salinity/sodicity, waterlogging, flooding, and loss of organic matter.

Box 20.4

Environmental Degradation

Arif Hasan and Ameneh Azam Ali look at the reasons for environmental degradation, the repercussions of deforestation, and industrial pollution.

The increase in the price of building timber is already adversely affecting the quality of housing in the country and the scarcity and cost of fuel wood is becoming a major economic burden on low-income communities. As a result, gas cylinders are in great demand, even in rural areas, as their monthly cost is less than half that of fuel wood.

One of the most visible, and perhaps the most significant, impacts of deforestation is soil erosion. The mountain regions where the majority of natural forests are located are characterized by steep slopes, fragile and thin topsoil, and unstable geological conditions. When tree cover is removed, there is nothing to stop the soil from being washed away by even mild rainfall. In addition, landslides and rock falls, which occur frequently in spring as a result of melting snow and ice, are exacerbated by the absence of tree cover. Vast areas of the Karakorams and Hindu Kush are naturally arid and barren, and little can be done to prevent or control soil erosion in these areas. But the historically heavy silt load of the Indus, which flows through these mountains, is being augmented now by large quantities of valuable topsoil swept off the slopes of the foothills and lower mountains in the monsoon zone. This erosion has a dual impact on the environment: it leads to desertification of once-productive upland areas, and silting-up of waterways in the plains, making them more prone to flooding. In addition, there is increased silting-up of irrigation and hydro-electric systems, lowering their efficiency and shortening their lifespans. The building of roads is probably the single biggest factor contributing to rapid deforestation. Previously inaccessible mountain areas, like the Kohistan district of NWFP, have in the last twenty years been connected to the plains by major roads. Transportation facilities have made the logging of these rich and ancient natural forests a viable commercial proposition. The extreme poverty and hardship of life in these remote areas has meant that the local communities have seized this opportunity to earn a substantial income in a short space of time, by selling their trees to down-country contractors. . . .

. . . Studies on Karachi have established that effluent from tanneries contains a higher pollution load of oil than the oil industry itself. In addition, it contains chromium and other toxic metal salts that are used in the tanning process, such as chlorides and sulphates of sodium and potassium. There is no on-site treatment of this effluent, not even the removal of suspended solids. The effluent from the cotton industry, though high in organic contents, is less noxious but does contain traces of chromium and copper. The cotton industries and tanneries are the most widespread industrial activity in Pakistan and are carried on through small, often informal units, in both the urban and rural areas. . . .

. . . Apart from small industrial units which pollute water bodies, most cities also have larger formal sector units that do the same. In Multan, the Pak-Arab Fertilizer factory releases highly polluted waste into the Multan canal, a major irrigation and drinking water source for animals. The effluent of 235 industries in Faisalabad is carried untreated to the river by the main drain of the city. At Kala Shah Kaku industrial estate in Lahore, the industrial effluent is also carried untreated to the river Ravi through the Deg nullah. . . .

. . . In addition to industrial emissions, a major source of pollution is from automobiles. Their number in Pakistan had increased from 575,558 in 1975 to over 1.654 million in 1984. Since then, it is estimated that they have increased overall by 30 per cent and are concentrated in about 8 major cities of the country. Studies carried out on traffic policemen working in the more polluted areas of Karachi and other studies on Lahore show that traffic emissions in these cities have become critical and are creating very serious health problems for the residents.

Source: Hasan, Arif and Ameneh Azam Ali, *Environmental Repercussions of Development in Pakistan* (Karachi: OPP-RTI, 1993), 40–9.

Table 20.6
Changes in Selected Environmental Indicators 1990 and 2000

	1990	2000
Area Under National Parks and Wildlife Sanctuaries (% of total land area)	9	10.4
Area affected by Desertification (% of total land area)	39.57	55.14
Area Under Forest Cover (% of total land area)	5.19	4.80

Source: Centre for Research on Poverty Reduction and Income Distribution, *Pakistan Human Condition Report 2003* (Islamabad: CRPRID, 2003), 241.

The greatest effect is by water erosion (17 per cent) followed by salinity (8.6) and wind erosion (7.6 per cent).

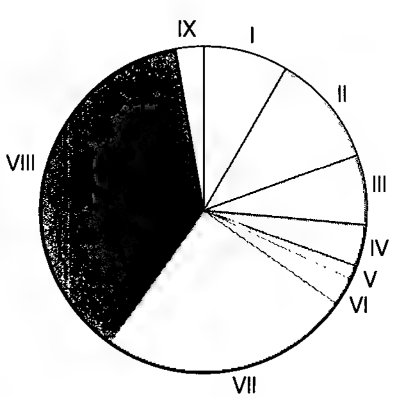
In the industrial sector, air and water pollution result from industrial processes, and with extensive urban growth resulting in an increase in mechanized vehicles, pollution levels in cities have reached critical levels, especially in the more industrialized sectors of urban areas. To these environmental effects of industrialization one can add the extent of 'encroachment by industrial units on farmland and on the habitats of various plants and animal life'.[23] A survey that examined industrial waste pollution in Karachi, Multan, Faisalabad, Nowshera, and Peshawar found that a number of industries were 'discharging effluents with high concentrations of pollutants varying from toxic metals and metal salts to bacteria, acids and salts'.[24] In Karachi, contaminated and heated sea water is sent back into the

Table 20.7
Land Capability Classifications

Land class		Soil limitations	Production potential
I	Very good agricultural land	None for general agriculture	Very high
II	Good agricultural land	Minor	High for general agriculture
III	Moderate agricultural land	Moderate	Moderate for general crops
IV	Poor (marginal) agricultural land	Severe	Low for a few crops only
V	Good forest or rangeland	None/minor for forestry/ rangeland	High for forestry/ range development
VI	Moderate forest or rangeland	Moderate	Moderate for forestry/range development
VII	Poor forest or rangeland	Severe	Low for forestry/ range development
VIII	Non-agricultural land	Severe	None for any type of economic agriculture

Source: IUCN, *The Pakistan National Conservation Strategy* (Karachi: IUCN, 1992), 22.

Figure 20.1
Land Capability by Classes



Land class	Land capability
I	Very good agricultural land
II	Good agricultural land
III	Moderate agricultural land
IV	Marginal agricultural land
V	Good forest or rangeland
VI	Moderate forest or rangeland
VII	Poor forest or rangeland
VIII	Non-agricultural land
IX	Unclassified

Total area: 61.82 million hectares

creek after industrial use, affecting sea life and the marine ecological balance. Contamination by petroleum hydrocarbon residues and chlorinated hydrocarbons is also common on the sea coast in Karachi. Along with industrial emissions, pollution from automobiles is also a major and growing problem in cities (see Box 20.4).

Like many other countries, in Pakistan environmental degradation and excessive rural and urban pollution are bordering on a near catastrophic situation, with growing concerns about ecological disasters, such as floods and other environmental crises. The trend is one of substantially increasing energy consumption, with a negative impact on the environment. Deforestation is destroying parts of the Potohar region where timber is being cut at a far faster rate than new trees are being planted. Salinity in much of Sindh is destroying potentially good-quality agricultural land, and is also affecting rural housing. Both deforestation and salinity are, and will continue to be, a serious potential threat to the rural sector. Industrial waste and emissions and pollution from cars and other vehicles in cities will exacerbate the problem, especially since urban growth is going to continue and industrial and manufacturing output is likely to expand.

In 1992 the Government of Pakistan adopted the National Conservation Strategy as an official policy document. The policy had three explicit objectives: (1) conservation of natural resources, (2) sustainable development, and (3) improved efficiency in the use and management of resources. Fourteen programme areas were identified for priority treatment:

1. Maintaining soils in croplands
2. Increasing irrigation efficiency
3. Protecting watersheds
4. Supporting forestry and plantations
5. Restoring rangelands and improving livestock
6. Protecting water bodies and sustaining fisheries
7. Conserving biodiversity
8. Increasing energy efficiency
9. Developing and employing renewable resources
10. Preventing/abating pollution
11. Managing urban wastes
12. Supporting institutions for common resources
13. Integrating population and environmental programmes
14. Preserving the cultural heritage

20.4 Institutional Issues in the Social Sector

The cliché-ridden New World Order is said to have had its beginnings in the mid-1980s following Michael Gorbachev's *perestroika* in the Soviet Union, finding its crystallization with the fall of the Berlin Wall in 1989. We are told that this is the triumph of the West and the End of History; the New Age is one of the free man and woman, unencumbered by the state; and freedom of choice and action are now set to dominate economic and political thinking.[25] This is the era where the neo-liberal synthesis has found its expression in economics and politics. Market-friendliness, privatization, deregulation, devolution and democracy are now the key clichés that form

the mix (and fix) for societies which were hitherto deviant from the norm adhered to in the West. With the demise of the bipolar world, the unipolar world sees itself as an elongated extension of the West to the non-West. The measuring-rod for success and achievement is now the ability to ape developed western countries in order to make development 'sustainable'.[26] Governance, democracy, and devolution form a critical union to make development sustainable, and are said to comprise the key prerequisites for progress.[27]

With the breakdown of the command economies of the former Soviet regime and its allies, devolution of control and power has been seen as a particular means for increasing participation, and hence, progress. Today, in matters of governance and government structures, huge centralized machineries that were deemed competent and capable of delivering on promises to their people have floundered. The new thinking has shifted away from the central and federal government's role in developing the economy and society, and has begun to incorporate the private sector and non-governmental organizations as important key actors in development strategies. Furthermore, the need for less bureaucracy, more efficient and timely delivery of services, and a closer and more direct access to the beneficiaries of development-related projects have also been important considerations in this shift in thinking and strategy—see Box 20.5.

Box 20.5

Government Intervention, Planning, and the Market

J. R. Behrman discusses the reasons why, in a neoclassical world, planning may still be necessary and why government intervention, rather than determination by the market, may be necessary.

> *Efficiency reasons* for policies include market failures due to externalities (that work other than through markets so private incentives differ from social marginal costs), increasing returns to scale/public goods (for which private incentives are to produce less than socially desirable, with information a particularly important example), local monopolies, and missing and incomplete markets (including capital and insurance markets for human resource investments). If there are efficiency reasons for considering policy interventions, alternative policies can be ordered in a 'policy hierarchy' in descending order of the number of distortions that the policies introduce. If policymakers had perfect and costless information both for policy design and for subsequent monitoring and enforcement, often there is a range of 'price' (tax, subsidy) or 'quantitative' (regulations, central directives) that could illicit the 'correct' outcomes. But in fact information is quite imperfect for policymakers and implementers. That implies that there is a premium on more transparent policies and policies that create incentives for efficient behaviour and accountability, particularly if they cannot be closely monitored in a timely fashion. A major problem in the provision of social services in Pakistan, for example, is thought to be the lack of client orientation and low accountability, which in considerable part reflects information problems in monitoring service delivery and in assessing client demands. In an uncertain world with asymmetrical information, there is a presumption that price policies are likely to be more effective in many cases on these grounds than quantitative policies or the direct provision of government services. There also is a presumption that more decentralized decisions are more likely to be responsive to the nature of local conditions than more centralized decisions, and that a broader sense of 'ownership' of activities is likely to increase efficiency. At issue is not a question of ideology regarding some general conclusion of whether market failures are pervasive, so that strong government interventions are warranted, or policy failures predominate, so that almost all activities should be privatized and left to the market. The question pertains to specific activities, in some of which the government may have comparative advantage and in others of which the private sector may have comparative advantage. Responsible governmental stewardship must recognize the differing comparative advantages of public versus private fulfilment of various activities, and not blindly reserve certain activities to one or the other.
>
> If there are *distributional reasons* for governmental interventions, two points merit emphasis. First, if a certain group is to be favoured by policies, there remains the question of what policies to utilize. Comparisons of the expected costs and benefits need to be made, which generally tends to point to policies that are higher in the efficiency policy hierarchy. For example, because society has a commitment to improve the human resources of the poor does *not* mean that direct public provision of education and health services is the best way to pursue that goal. In some circumstances (but certainly not in all circumstances), it may be more effective in terms of this commitment to provide subsidies directly to the poor (perhaps tied to specific uses, such as schooling) and let them choose their provider from among the private and public alternatives rather than channelling all such subsidies directly to public sector providers and thereby limiting the pressures on public sector providers to be more effective and limiting the possible choices for the poor. Second, almost all policies have distributional impacts, favouring some group or other, and not necessarily the poor by any means (in fact often not the poor). Often among the groups that have the strongest vested interests in particular policies, moreover, may be government employees. Therefore it is all the more important that policies, whatever their rationale, be as transparent as possible and subject to periodical review so that they do not continue long after the problem to which they originally were addressed has passed simply because they have created a strong vested interest in the public or private sectors.

Source: Behrman, J. R., 'Pakistan: Human Resource Development and Economic Growth into the Next Century', mimeo, 8 May 1995, 3.

Not only has there been a move away from government control; there has also been a noticeable shift *within* government structures. Furthermore, the concept of government itself has changed. The control economies of eastern Europe, and the military governments in much of the Third World, have been replaced by some form of democratic regime. There is agreement now that strong centralized states are out of tune with the reality on the ground, and thus there has been a growing demand for more active participation, and hence, *devolution*. The controlling federal/central state has been forced to extend more powers to smaller units at the provincial, district, and local level, so as to enable these units to play an active role in providing welfare to the people. This has happened in Pakistan as well, in numerous guises, either as military led devolution, or then greater provincial autonomy and responsibility passed on to the federating units—see Chapters 12 and 13 in Part IV. More autonomy has been granted to provincial and state governments, and local municipal government has also been expected to play an increasingly prominent role. While the world climate has been the critical factor in causing this shift of emphasis,[28] the economic constraints faced by many, if not most, underdeveloped countries have helped accentuate this shift.

Many developing country governments, including Pakistan, find themselves in dire financial straits and are forced to reduce public expenditure to cut the budget deficit, and to restructure their economies. In fact, after 2008, this 'third world' problem has also engulfed many countries in the developed West as well, such as Spain, Greece and Portugal. The term 'structural adjustment' acts as a metaphor for the state of the economy in most underdeveloped, as well as in some advanced, developed countries. Budget cuts—an essential ingredient of any Structural Adjustment Programme—have meant that central/federal governments have had fewer funds to make available to lower echelons in the hierarchy. Thus, provincial and local governments that were dependent on the state have now had to become more disciplined financially, and have seen their grants and aid cut. It is this dual shift—a resource constraint faced by the federal government, and the belief that more participation and devolution of power and control leads to better, more effective, and sustainable development—that has brought local governments, the private sector, and non-governmental organizations into the foray of development planning.

Pakistan, too, has been influenced by these changes in thinking and perception taking place at a global level. While the structural adjustment programme, with its multifaceted emphasis on privatization, deregulation, and liberalization, has been accepted wholesale by different governments in Pakistan, often without enquiry about the possible repercussions (see Chapters 16 and 17), the institutional and governance issues have yet to be tackled—and for obvious reasons, we will argue.

Nevertheless, there is a growing debate about and awareness of issues related to the delivery and functioning of the social sector in Pakistan. There is a general belief that social development has been poor, not because facilities have been inadequate in number, but because organizational and managerial issues, and issues of delivery, have ensured poor progress. There is growing recognition of a need for change in the way social development is delivered. Even official government documents have started paying lip-service to the need for administrative reforms: 'the effectiveness of planning and administration has progressively been eroded by the growing inability of government to effectively implement its policies'.[29] The government believes that it has not been able to make collective decisions in the past, a major reason for which is

> that all administrative, political and even scholarly attention has been focused on bureaucratic and centralized forms of collective decision making, with little attention towards representative decision making (as in the parliament, cooperative societies, district councils), and downright hostility towards participatory decision making arrangements. This needs to be reversed.[30]

Moreover, the government believes that 'effective reform of local government institutions has to be at the core of any development strategy aimed at the alleviation of poverty or the development of the social sectors'.[31] Reforms that have been undertaken under the 18th Amendment in 2010, are meant to address these shortfalls and transfer greater responsibility and revenue on the federating units, the provinces. See Chapters 12 and 13 for further details.

As in the past, the commitment to the social sector is supposed to have 'transparent and accountable' government as an important cornerstone. 'This transparency will entail decentralization, better monitoring and accountability of public institutions and greater involvement and strengthening of civil society instruments, primarily NGOs [non-governmental organizations] and CBOs [community-based organizations].'[32]

20.5 Governance, Decentralization, and Local Level Delivery

One of the key concepts to emerge in the present world climate is that of governance, a term applied particularly to underdeveloped countries.[33] While it is not the objective of this section to examine the epistemological, philosophical, or political genesis of this concept, some comments on the concept will be useful to our discussion.[34]

Governance has been described as 'an act or manner of governing, of exercising control or authority over actions of subjects, a system of regulations'[35] and 'reflects a judgement on the quality of government'. 'It refers to a certain system of politics and how this functions in relation to public administration and law. Governance has also been used to focus specifically on development. Governance, in this context, means the manner in which power is exercised in the management of a country's economic and social resources for development.'[36] Among the earlier public statements on good governance is the 1989 World Bank report on Africa, where the concept included the following features:

'an efficient public service; an independent judicial system and legal framework to enforce contracts; the accountable administration of public funds; . . . respect for the law and human rights at all levels of government; a pluralistic institutional structure, and a free press'.[37] In later works, a clearer idea of the World Bank's understanding of the concept emerges, where good governance is synonymous with sound development management.[38]

M. Halfani and his associates, in their work on the implications of governance for urban research in developing countries, state that governance is distinct from government and 'refers to the relationship between civil society and the state, between rulers and the ruled, the state and society, the government and the governed'.[39] According to Tariq Banuri, the crisis of governance 'refers to an excessive degree of centralization, overburdening, and rigidity of the government machinery; the absence of local participation which can provide the requisite attention to detail; the deterioration in the professionalism, competence and integrity of public functionaries; and the weakening of judicial and quasi-judicial institutions'.[40] While it is clear even from this insufficient selection of definitions that 'the meaning of governance depends on who is looking at the term and what he/she is looking for',[41] there does seem to be a core body of concern and focus. However, given the ambiguity and ambivalence in the use of the term, good governance has also been used by pro-marketeers, wherever found expedient, to mean *minimum* government.

In a sense, the term reflects within it almost all facets of civil society and government, and the relationship between the two. Economic development needs to be examined with its social and cultural consequences. Governance also encompasses the relationship between participation and development by governments. Furthermore, community participation, the role of women, sustainable development, and economic effects on the environment and consequently on the population all form some part of the concept of governance. It is a huge term used to capture a large number of ideas about political, social, and economic development. Not only is governance about how governments function, but it is a multi-relational concept of society as a whole. One cannot argue that governments per se are inefficient and corrupt, and have no respect for the law—though this is true in most underdeveloped countries—without examining the links with the nature of society in which government functions. We need to examine the level and structure of economic development and of society, the historical and cultural traditions of particular societies, and the influence of the government on civil society, before any concept of governance emerges. Furthermore, particular perceived facets of good governance, such as community participation, need not be 'good' or beneficial in all societies, regardless of specific social structures. Essentially then, even if there is some general consensus about what constitutes (good) governance, these rules need not be universally applicable. With these remarks on what constitutes the varied concept of governance, we examine the role that the government has played in development in Pakistan.

20.5.1 Government and Development in Pakistan

While there may be differences of opinion about what constitutes the concept of governance—good or bad—there would be little disagreement over our claim that governance has been noticeably poor in Pakistan. On this single count alone, most conceptualizers of the term 'governance' would agree. Public participation, or democracy, must surely be one of the central tenets of any definition of good governance. Pakistan's political leaders have carefully done away with this feature altogether.

Thirty-one of Pakistan's 65 years have been ruled formally by three military rulers at different junctures of its history. From 1947 to 1985, only one free and fair general election was held, and even then, Zulfikar Ali Bhutto's democracy would hardly be termed a model of good governance. 1985 saw a military dictator hold a form of general election, where individuals rather than political parties were given the right to participate. Ironically, though, the three-year period (1985–8) with Mohammad Khan Junejo as prime minister, despite the domination and control of General Zia ul-Haq as president, can be considered to have provided better government and governance than the democratic regimes of Z. A. Bhutto, Benazir Bhutto, and Nawaz Sharif. General Pervez Musharraf's coup in October 1999, put an end to the eleven year process of electioneering in Pakistan. He also followed General Zia's footsteps by becoming President while he remained Chief of the Army Staff, and also held elections in 2002, which were controlled and managed by the army from within. The lack of popular participation in Pakistan would suggest that the system of governance has been quite poor.

With regard to the social sector and social development, it is generally believed that the main obstacle to the achievement of comprehensive development in Pakistan has been the crisis of governance. Giovanni Cornia writing some years ago, defined this as the crisis

> of the government's ability to design and implement policies, particularly policies which require targeting, selection or judgement. Such crisis manifests itself in the fact that over the years the GOP [Government of Pakistan] has become excessively centralized; that participatory institutions have eroded, and are virtually non-existent today; that the hostility towards participatory institutions and local-level democracy has led to the gradual erosion of the self-confidence, the skills and the system of grass-root institutions needed for organizing collective action; that the breakdown in professional standards, lax supervision and growing corruption of large sections of the civil service (including those dealing with education, tax administration, law and order) and arbitrary procedures are causing a severe crisis of legitimacy of government institutions which are no longer perceived as acting in the public interest.[42]

Having identified the problem, Cornia argued further that it is imperative that reform of the state apparatus take place, even though such a reform will be 'painful and difficult', but there is urgent need for greater 'participation of civil society in the design and execution of social sector activities'.[43] What this requires is that *institutional reform* take place, so that basic functions of the state 'such as public security, fair judicial recourse, enforcement of contracts, and so on, are actually being fulfilled'.[44]

Along with institutional reform to bring about some semblance of good governance, advocates of this line of thinking also believe that better delivery of social services requires decentralization: the hold and role of the central government should be weakened, while the role of lower tiers of government and other participants in the social sector matrix should be increased. Asad Sayeed argues that the centralization of the delivery mechanism is among the most serious impediments to the provision of adequate social services. As an illustration of the excessive extent of centralization, he cites the example of the rural water supply schemes (RWSS) and argues that:

> in RWSS the provincial Public Health and Engineering Departments (PHEDs) are responsible for not only the development of water supply schemes but they also perform the function of O & M [operation and maintenance] and revenue collection. Originally established for the provision of urban water supply schemes, the PHEDs have approached the problem of rural water supply and management from the standpoint of urban needs with the consequent urban bias in technology. Institutionally local government and its related departments (such as the LGRDD) [Local Government and Rural Development Department] are designated to provide for RWSS. But because of the weak financial and technical base of local government, this role has de facto been handed over to the PHEDs. With little interest in the collection of revenues (as their budget is not affected by recovering revenues) monitoring of projects is weak. The RWSS case illustrates that in spite of the mandate given to local government, its weak financial and technical base renders it incapable of performing these tasks. Similarly, in other social sectors also, according to the Local Government Ordinance of 1979, local bodies have the mandate to undertake development and O & M work for social sectors, but for the above reasons they have, by and large, abdicated this responsibility to provincial governments.[45]

Giovanni Cornia believes that to break the hold of the federal/central governments, decentralization should take place not just at the provincial level, but beyond, at the district and local/union level. His rationale for decentralization is that

> the greater closeness of public administration to the problems of society allows for faster and more relevant and efficient decisions concerning local needs. In addition, decentralization allows for more genuine democratic control from the beneficiaries of the services (through school boards, parent commissions, user associations, etc.): such informal bodies should provide support to teachers and health workers, oversee the attendance to and quality of services, decide on the siting of new facilities, provide additional resources, etc.[46]

The third key requirement for better governance, along with institutional reform and decentralization, is community participation and democratic control.

> The case for a far greater reliance on the communities, their local representative bodies and the NGOs in Pakistan is a strong one. Greater reliance on community participation and social mobilization in the design, delivery and monitoring of social activities ensures in the first instance, a greater relevance of these programmes to the actual needs of the population, and a greater internalization of their benefits by the poor and unreached. In addition, community-based programmes generally employ less unnecessarily skill-intensive approaches and ensure greater overall efficiency. Community participation also facilitates the mobilization of additional cash resources and of other resources in kind such as labour and locally available material which have a low opportunity cost but intrinsic productive value. And, finally, the active involvement of the community enhances the sense of self-reliance and responsibility of people and their ability to take care of their lives.[47]

The fact that military governments have ruled Pakistan directly for around half of Pakistan's existence since 1947, and given the fact that the military is, by definition, an hierarchical, centralized, command, institution, one also sees government in Pakistan, to ultimately be controlled by the military in its own image. Yet, to be fair, military governments have been the only forms of government in Pakistan to actively encourage local governments to function somewhat autonomously—see Chapter 12—although the military continues to hold on to all relevant aspects of administrative structure. Decentralization does take place, but is in constant tension with the centralized nature of the military. There is also a general impression, that military forms of authoritarian governance 'work better', or at least more efficiently, than the messy form of democratic participation. This perception is probably not incorrect, where the military form strides through in following orders and undertaking decisions without much consultation, with little opposition, and being 'efficient' and productive. A non-consultative, top-down, authoritarian, development, process might sometimes have its advantages, when 'the people' are given what someone in command or authority deems they need. However, increasingly in Pakistan, the model of development has moved to one which is more participatory, consultative and democratic.

20.6 NGOs and Community Participation[48]

No one knows how many non-governmental organizations (NGOs) exist in Pakistan. Whatever their number, only a few of them are officially registered, and there are an unaccounted larger number of unregistered organizations which pose as NGOs, providing some service or the other. Of those that are registered, most are registered under the voluntary Social Welfare Act, while the remainder are registered under the Societies Registration Act, the Trust Act, the Companies Act, or the Charitable Endowment Act.

Not surprisingly, given greater population densities and proximities, most NGOs are urban based with different focuses of locational and operative interest. Each NGO has its own particular philosophy, priority, focus, area, and manner of interaction with its client population. Despite the very large number of NGOs in different regions in Pakistan, most NGOs are highly localized—in fact, this is one of the key elements that distinguishes NGO activity from other types of intervention. There were fewer than two dozen NGOs that have a national coverage. Approximately 70 per cent of the registered NGOs were in the Punjab, probably because of the higher level of urbanization in that province. Despite the preponderance of urban NGOs in Pakistan, it is probably some of the rural NGOs which have achieved international fame for achievements in the past. The most well-known NGO in Pakistan is probably the Aga Khan Rural Support Programme established in 1983 with work in the Northern Areas and Baltistan, and its off-shoots, the sixteen Rural Support Programmes.

There are essentially four types or categories of NGO working in Pakistan. These are as follows:

1. Welfare oriented, charitable or philanthropic organizations, which provide social services mainly to the poor and underprivileged.
2. Grassroots development organizations, which work with specific targeted communities for the development and economic and social uplift of the area or people; these are often service providers—or contactors, according to one view, see Box 20.6—substituting for government.
3. An increasing number of NGOs not just of/for women, have now become advocacy-based, lobbying for different laws, provisions, etc. These include human rights groups, justice and consumer protection groups.
4. Women's NGOs, which specifically target and focus on issues related to the economic and social status of women. Activities of these NGOs are not restricted to the delivery of social services alone, and research, information, dissemination, legal advice and advocacy, and other development issues are also on their agenda.

In the 1940s and 1950s, NGOs were mainly charitable and philanthropic organizations, but since the 1970s, and especially in the 1980s, NGOs have 'stepped into welfare oriented roles as the state system increasingly failed to deliver. After the seventies [the] shift has been towards development community based initiatives.'[49] Most NGOs receive financial support from community contributions, local donors and often receive funds from the government through the Social Welfare Departments of the provincial governments. Increasingly though, funding from international donors has become a major component of funds for NGOs.

Most NGOs in Pakistan are welfare oriented. They are usually operative at the level of neighbourhoods and 'are involved in the provision of civic amenities such as basic health, education, library facilities, vocational training, youth programmes, credits, income-generating activities,

Box 20.6

NGOs and Civil Society

NGOs and civil society in Pakistan, are criticised for supporting military governments and for becoming contractors to government.

The term 'civil society' is a complicated term which means different things to different people and is used in different contexts. Even in the more settled western societies, it has a changing meaning: late-20th century events have made the category more fluid, with civil society actors and constituents, moving in and out of the realm of civil society over a period of time.

In the countries of the East and the South, the location of the term civil society and its meaning becomes even more complex. While there are different notions and contexts about what civil society is and is not, there is at least some broad agreement about what it must necessarily be. Civil society is supposed to be outside, and perhaps preferably in opposition to, or in contradiction with, the state.

In order to define civil society, it is a requirement that the organizations and actors of civil society not be controlled by the institutions or actors of the state. This 'autonomous' requirement is a necessary condition to distinguish civil society from the state.

For some more radical thinkers, the stricter requirement is that civil society must stand against both state and market, and particularly against economic liberalism. For them the 'state, market and civil society are rival channels for the exercise of power'. For other theorists, civil society must necessarily be a democratising force. Howsoever one defines civil society and its constituents, the Pakistani case offers interesting (and contradictory) insights about the nature and form, and location, of civil society. It also shows the large number of contradictions which constitute the political settlement that is Pakistan.

Despite the fact that General Musharraf in October 1999 overthrew an elected prime minister, albeit an incompetent one, the largest and most public support for him came from the socially and culturally liberal and westernised sections of Pakistan's elite, who embraced Musharraf as one of their own, which he very much was. Activists in the NGO movement in

Pakistan were also vociferous in their support for Musharraf, precisely because he was seen as a liberal and westernised man.

Some prominent members of the NGO movement who had struggled for a democratic order in Pakistan when it was under General Zia ul-Haq, actually joined Musharraf's cabinet. Employer's associations, trade bodies, women's groups, and other such groupings which are all part of some acceptable notion of civil society, also welcomed the coup because General Musharraf was seen as a modernising man. Some intellectuals and peace and anti-nuclear activists also celebrated the arrival of a liberal head of state.

Clearly, for the westernised sections of civil society in Pakistan, the military general who had overthrown a democratically elected prime minister, was Pakistan's latest saviour. Musharraf's earliest critics and opponents included, what for lack of a more appropriate term one can call, the Islamic civil society, which did not like his liberalism and westernisation. Classical and western literature on civil society suggests that by being 'against the state' in some ways, and especially by being against the autocratic undemocratic state, civil society is necessarily on the side of some form of a democratic dispensation. Not so in Pakistan.

For civil society in Pakistan, whether of the westernising, modernising kind, or of the more fundamentalist Islamic kind, the question has not been one of democracy versus non-democratic norms, but of liberalism against perceived and variously interpreted Islamic symbols and values. Unlike the traditional notion of civil society, the pursuit of democratic ideals is not a necessary and defining condition. Not only is this a fundamental difference, but so too is the necessary distinction of autonomy from the state, so integral to the meaning of civil society.

If sections of civil society are expected to challenge the state, in Pakistan, there are many who are the state's partners. For instance, development groups which have emerged as a result of government failure in Pakistan and have become contractors in the form of NGOs in their own right, are often co-opted by institutions of the state to become the latter's 'advisers,' winning lucrative contracts and getting the publicity they need to further their credentials.

Human rights activists and advocacy groups, too, become partners with other stakeholders, particularly government, and try to redress problems created by the very institutions of the state that they are now partnering. The essence of Pakistan's politics—very broadly defined—is one of compromise not confrontation, and of co-optation. Civil society in Pakistan is very much part of that political tradition.

Linked to this relationship with politics, and perhaps determining it, is the relationship of civil society and of NGOs with money, particularly donor funding. If, for example, the most prominent and potentially radical civil society organizations in Pakistan receive funding from donors who have specific interests or agendas, the 'politicalness' of these organizations gets muted. With the British and American governments amongst the biggest donors of civil society in Pakistan, one does not see much protest against them for their role in the occupation of Iraq and Afghanistan. After all, these governments are imposing their liberal social agenda on the two countries, an agenda which the westernised sections of Pakistani civil society endorse.

Moreover, the requirement that civil society be autonomous of the state is also undone since many of these NGOs, are highly dependent on foreign donor state. It is the broader westernised, 'liberal', modern (but in the case of Pakistan, non-democratic) vision, which western governments share with the elite and the westernised sections of those who constitute civil society in Pakistan—not with the Islamic elements or sections of civil society.

The greatest opposition to the foreign presence in Iraq and Afghanistan, and to Israel has come from the political and non-political sections of the 'Islamic' civil society. Unlike their westernised Pakistani cousins, this is an anti-imperialist political grouping, which is also against the agenda of the World Bank, the IMF, and economic liberalism, something that westernised civil society supports very enthusiastically. For both, however, democracy is less important.

Most definitions of civil society do not stretch themselves to include film societies, debating clubs or puppet and theatre festivals. Yet, because these entities have a political and radical cultural presence in the context of an Islamicized (and violently so) society like Pakistan, they can be included in a non-western context as belonging to civil society.

Even such benign civil society organizations seek patronage from the chief of the army staff, who is also the president of Pakistan, to further their cause: General Musharraf was the chief guest at the inaugural and closing ceremony of a puppet festival and a film festival, respectively, some months ago. While these cultural preferences may be the redeeming feature of Pakistan's military coup maker, one should not forget that Beethoven and Goethe were claimed as the cultural ancestors of a certain group of Germans not six decades ago.

One is not stating that Pakistan's experience is in any way unique, but one will argue that perhaps civil society ought to be defined by the conditions in which it exists so that one can understand its functioning and politics better. While Pakistan's civil society is an outcome of its particular history and the way its institutions and politics have evolved, it is, nevertheless, essential to apply some minimum acceptable norms of civil society behaviour, to be able to evaluate its role and performance.

In the context of Pakistan, one is likely to find that civil society (its western wing), aspires to only a few of the necessary requisites. For it, a westernised, socially and culturally liberal agenda, is far more important and preferable than the messy indigenous politics essential for democracy. In fact, one of the main consequences of this ideology has been the depoliticization of public life in Pakistan. Under such circumstances, where the main representatives of the uncivil society are perceived to be westernised and socially and culturally liberal, where civil society actors work for the emancipation of women and for human rights, and military generals support the same agenda, both civil society and 'uncivil society' make consenting bedfellows.

Source: Zaidi, S Akbar, 'Defining Civil Society', *Dawn*, Karachi, 18 August 2006.

etc. Education and social community services are priority areas of NGO activities'.[50] Development-oriented grassroots organizations with specific and focused objectives, such as rural development, provision of urban water supply and sanitation, have emerged over the last thirty years or so, as have NGOs with a specific women's focus. The more general advocacy-based organizations are the most recent, emerging in the early 1990s. Khawar Mumtaz identified the following issues faced by the NGO sector in Pakistan:

i) uneven quality of service;
ii) limited attention to developing the indigenous capacity of the people;
iii) weak structures and means to become self-sustaining;
iv) social welfare orientation;
v) vague and limited objectives specific to immediate problems;
vi) inability to conceptualize for long term objectives;
vii) non-professional in outlook resulting in incompetent management of accounts, planning and budgeting;
viii) top-heavy structures, lacking in mid-level cadre of professionals or trained support staff. Shortage of staff was a major problem identified by NGOs;
ix) almost all operate with limited budgets relying usually on community contribution or local donors;
x) absence of capacity to expand or absorb additional funds
xi) no systematic monitoring of activities by themselves or government;
xii) weak coordination between NGOs; largely operating in an isolated manner.[51]

Community development based on the principles of community participation is seen as a key component of an alternative strategy for social sector development. This view rests on the central premise that local communities are the best protectors of their own interests and hence should play a more active role in their own development. Tariq Banuri and Moazzam Mahmood put the theoretical argument as follows:

> Define a community on the basis of relative spatial proximity, like a village or an urban *abadi*. This very largely also defines the community in terms of common requirements for social services, like education, health, housing, water, sanitation, roads, energy needs, and the environment. It also defines the community in terms of basic classes, and therefore employment and income needs. If the community has a set of common social service requirements, then the community's perception of the problem is the highest. If its perception of the problem is the highest, then the community's solution to the problem will be the most relevant and useful under any given set of constraints. And the community's response to the problem will also be the fastest.[52]

Having defined the community as the principal agent of change, the two authors maintain that the role of the community then becomes one of deciding 'what services to demand under a given set of constraints; it establishes a clear responsibility with the community, and gives the system an endogenous dynamic which is not immediately obvious to traditional development strategy'.[53]

Community participation along with NGO-oriented activity now forms a critical component of the new conventional wisdom of development. As Asad Sayeed argues:

> It is now acknowledged across the board that monitoring the efficiency of delivery at the grass roots as well as several other mediatory tasks can be best performed by non-governmental organizations (NGOs). NGOs can articulate the beneficiaries' needs to project authorities, provide information about the scheme to communities, organize community based organizations to maximize their gains from schemes, deliver services to less accessible populations and serve as intermediaries to other NGOs. Government, on the other hand, can also learn from alternative development strategies pursued by NGOs.[54]

However, while there has been a growing consensus around the belief that NGOs, as an alternative 'development paradigm', offer an answer to state failure, *NGO failure* too concerns academics and practitioners, and the NGO sector, rather than being promoted wholesale, needs to be critically evaluated[55] (see also Appendices 20.2 and 20.3 for concerns raised about community participation and NGO activity).

The Social Action Programme (1993–6, and 1997–2002), with its emphasis on decentralization, community participation, and NGO involvement, was not the first of its kind to include such components. The 1978 'Health For All by the year 2000' strategy, endorsed by almost all underdeveloped countries, also required these ingredients.[56] Many of the issues pertinent to primary health care are equally important to the Social Action Programme in Pakistan today. Appendix 20.2 explains how and why community participation and NGO-led development strategies do not always work. Appendix 20.3 provides an intriguing look at the NGO sector in Pakistan, indicating that what would have been a useful channel for development has now become a racket for making money and offering patronage[57]—see also Box 20.7.

Conventional wisdom and liberal politics (which, incidentally, are closely related) offer decentralization, local-level delivery, and community participation as yet another panacea for solving the problems of countries like Pakistan.

Adherents of the decentralization and community participation argument *almost always overlook issues of political, social, and economic power and differentiation*. It is not possible to conceive of communities without a degree of hierarchy, although conventional wisdom consciously and repeatedly does exactly this. Patronage and power are equally present in all their manifestations at the 'local' level as at the higher level, and the platitudes offered by proponents of participation seem rather hackneyed.

We conclude this chapter with some extracts from a paper by Jean Dreze and Haris Gazdar, based on their research in Uttar Pradesh in India. The similarities between Pakistan and one province of 170 million people in India merely exemplify

Box 20.7

How Independent are NGOs?

This is an extract from a report which critiqued NGOs as political and developmental actors.

Not a spontaneous social phenomenon

NGOs make out that they have spontaneously emerged from society, hence the earlier term 'voluntary agency' and the now-favoured term 'civil society organization'. In fact, however, international funding agencies (from which smaller NGOs in various countries in the third world receive their funds) depend heavily on funds from government, corporate and institutional sources. For example, according to the World Bank document 'Report on Development: 2000–2001', more than 70 per cent of projects approved by the World Bank in 1999 included the participation of NGOs and representatives of 'civil society'—a single project aimed at bolstering NGOs over seven countries cost $900 million. The Bank assigned two of its functionaries to relations with NGOs and representatives of 'civil society'; that figure has grown to 80 today. As for governmental support, another report puts funds to NGOs from advanced industrial countries other than the US at $2.3 billion in 1995; including the US, the figure would be much larger. As one writer puts it, 'These gigantic sums reveal the hoax of presenting the rapid growth of NGOs as a "social phenomenon".'

Why do multinational corporations, the imperialist governments and institutions such as the World Bank and the United Nations channel such funds to NGOs?

Indeed the extraordinary proliferation of NGOs serves imperialism in a variety of ways.

1. NGOs, especially those working to provide various services—health, education, nutrition, rural development—act as a buffer between the State and people. Many States find it useful to maintain the trappings of democracy even as they slash people's most basic survival requirements from their budgets. NGOs come to the rescue by acting as the private contractors of the State, with the benefit that the State is absolved of all responsibilities. People cannot demand anything as a right from the NGOs: what they get from them is 'charity'.

Till the 1980s, NGO activity was limited to 'developmental' activities—rural uplift, literacy, nutrition for women and children, small loans for self-employment, public health and so on; this continues to be a major sphere of NGO activity. But in what context are these 'developmental' activities taking place? In the basic context of enormous, conscious *suppression of development*. Under the guidance of the IMF and World Bank, successive governments slashed their expenditure on rural development (including expenditure on agriculture, rural development, special areas programme, irrigation and flood control, village industry, energy, and transport).

In comparison with this giant spending gap, the sums being spent by NGOs in India are trivial. But, by their presence, *the notion is conveyed all round that private organizations are stepping in to fill the gap left by the State*. This is doubly useful to the rulers. The political propaganda of 'privatization' is bolstered; and, as said before, people are unable to demand anything as their right. In effect, NGO activities help the State to whittle down even the existing meagre social claims that people have on the social product.

Thus NGOs are multiplied fastest where State policies—usually as part of an IMF/World Bank-directed policy—are withdrawing basic services such as food, health care and education. The greater the devastation wreaked by the policy, the greater the proliferation of NGOs sponsored to help the victims. (Indeed, before the US prepares to invade a country, it funds and prepares leading NGOs to provide 'relief' after it has rained destruction. Thus in the second half of 2002 NGOs began cutting their spending on, and manpower deployed in, still-devastated Afghanistan—as part of their preparation to join the US caravan to Iraq.)

2. In the course of recruiting their manpower, the NGOs give employment and a small share of the cream to certain local persons. These persons might be locally influential persons, whose influence and operations then benefit the NGO. Or they might be vocal and restive persons, potential opponents of the authorities, who are in effect bought over. In either case, NGO employment, although tiny in comparison with the levels of unemployment in third world countries, serves as a network of local political influence, stabilizing the existing order.

3. In the field of people's movements, 'activist' or 'advocacy' NGOs help to redirect struggles of the people for basic change from the path of confrontation to that of negotiation, preserving the existing political frame. The World Bank explains in its 'Report on Development' (cited above) its *political* reasons for promoting NGOs. It says: 'Social tensions and divisions can be eased by bringing political opponents together within the framework of formal and informal forums and by channelling their energies through political processes, rather than leaving confrontation as the only form of release.' Thus ever since the early seventies Andhra Pradesh, a state with a strong tradition of revolutionary movements, has witnessed a massive proliferation of NGOs, and is indeed among the states receiving the maximum foreign NGO funds today.

NGOs bureaucratize people's movements. Traditionally, people's movements are self-reliant: they have to raise their own resources, and are led by representatives from among the people. These representatives, to one extent or another, thus have to be accountable to the people. By contrast, NGO-led movements, while claiming to represent the people, are led by officers of the NGOs, who are paid by funding agencies to carry on activity. Naturally, they are not accountable to the people, nor can they be removed by them; so they are also free to act without regard for people's opinions. On the other hand, NGOs *are* accountable to their funders, and cannot afford to stray beyond certain bounds. *Minus foreign and government funding, the entire NGO sector in most countries would collapse in a day.*

Indeed, as NGOs proliferate and spread their wings, setting up funded adivasi organizations, dalit organizations, women's organizations, 'human rights' organizations, cultural organizations and organizations of unorganized labour, it is often NGOs that are the first to respond to any political or social issue—including 'globalization' and its harmful effects. Political life itself is increasingly NGOized, that is, bureaucratized and alienated from popular presence and representation.

Source: Research Unit for Political Economy, *The Economics and Politics of the World Social Forum: Lessons for the Struggle against 'Globalization'*, Aspects of India's Economy, No 35, Research (Mumbai: Unit for Political Economy, September 2003).

the fact that many of the problems faced by underdeveloped countries are quite similar. They write:

> given the current political links between the schooling establishment and the rural élite, formal decentralization cannot be expected to achieve very much unless it goes hand in hand with more active political mobilization of disadvantaged groups.[58]
>
> Privileged groups (usually high caste landlords) have exercised tight control on local government institutions, and use them to their private advantage at the expense of public needs.[59]
>
> Decentralization was perceived as a problematic issue from the very start. Those familiar with rural inequalities warned that devolution of political power might well result in the enhanced tyranny of dominant élite groups. As a matter of fact, it soon became clear that political power at the village level remained with the propertied classes. Contrary to common expectations based on an idealized view of harmonious village coexistence, the introduction of new elected bodies led to exacerbated tensions in the early years.[60]
>
> This system of patronage-based governance is not simply a localized phenomenon, it has corrupted political institutions at all levels. Leading political parties have played a critical role in the development of this perverted system of governance. In these circumstances, it would be naive to expect state action to promote social opportunities on a wide basis, or the electoral process to act as a sound instrument of accountability.[61]

And finally,

> In the present political climate, it would be naive to expect the government to initiate major reorientation of development priorities on its own, or on the basis of bland expert advice.[62]

What this array of quotes from the paper by Jean Dreze and Haris Gazdar highlights, is the reality that decentralization, community participation, local government, etc. are terms and concepts which, rather than being promoted and endorsed enthusiastically, *need to be seen in light of relations of power, patronage, class, and gender*. While there are certainly numerous benefits from promoting development along the lines that many academics and developmentalists suggest, caution and open-mindedness are essential. Perhaps the answer to many of Pakistan's problems are to be found, not in NGO (civil) society, but in political praxis and greater activism outside of donor funded projects—see Box 20.8 on the unlikely impact of devolution on women, and Box 20.9 for a critique of the new fashion of community participation and devolution.

20.7 Summary and Further Reading

20.7.1 Summary

Having examined the factual position and the salient issues in a large group of areas which make up the social sector, we have looked in this chapter at the overall institutional issues and issues of governance and delivery, as well as at MDGs and gender. We have examined how, due to the failure of conventional top-down approaches to development, usually led by the state, new approaches have evolved and been implemented.

Some non-traditional social sectors have been evaluated in this chapter, starting with gender inequality. All statistics show that women fare far worse than men in an already underdeveloped social sector. This lack of development, which exists for historic reasons of patriarchy, class, and power, continues even in the twenty-first century. However, development, no matter how conceived, cannot succeed unless there is equal participation by women. Women are, in many ways, the core of economic activity in the country, though their contribution is neither recorded nor lauded. While incentives and changes in policy at the margin may help in promoting economic and social sector development, unless the cultural, historical, political, and social issues of gender discrimination are addressed, it is unlikely that women's emancipation will take place.

The focus has now moved towards participation, devolution, and NGOs. New ways of thinking had been ostensibly designed for Pakistan under the Social Action Programme, focusing on a handful of sectors, but promising new delivery mechanisms. Although large amounts of money were spent on the Social Action Programme, we now know that the programme was a failure. Moreover, the programme imposed high financial costs on both federal and provincial governments. The community participation spirit and the 'new way' of delivery were also lacking.

Much of this chapter has examined, in some detail, the alternative development paradigm—governance, decentralization, NGOs, local government, etc. We find that there is far more hype and rhetoric than substance and reality to many of the claims made by and about this so called alternative paradigm. By ignoring issues of class, gender, and power, much of what constitutes the philosophy of the new thinking is mere wishful thinking. While decentralization, delegation, and more local government are possibly a better mechanism for delivering development, enthusiasm needs to be tempered with some caution, and should take cognizance of the contradictions existing even at the local level.

20.7.2 Further Reading

On institutional issues, local government, and decentralization see Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Karachi: Oxford University Press, 1998); Zaidi, S. Akbar, 'Karachi: Prospects for the Future', in Khuhro, Hameeda (ed.), *Karachi: Megacity of Our Times* (Karachi: Oxford University Press, 1997); Zaidi, S. Akbar, 'NGO Failure and the Need to Bring Back the State', *Journal of*

Box 20.8

Women Suffer on Account of Devolution

While devolution under the 18th Amendment is widely celebrated in Pakistan for giving provinces more rights and responsibilities, Afiya Shehrbano Zia shows how some women have inadvertently had to pay the price for the politics of the transfer of shelters for women, from the federal to the provincial governments.

A few months ago, the National Commission on the Status of Women (NCSW), chaired by the seasoned women's/human rights activist, Anis Haroon, authorized an independent, nation-wide study on the 26 Shaheed Benazir Bhutto Women's Centres (SBBWCs). Completed in October 2011, the unambiguous conclusion of this study was that the SBBWCs provide a crucial and invaluable service to women victims of gender-based violence.

The study finds that 'such institutions need active and considerable support from all provincial governments, women's rights groups, civil society and NGOs. While there is considerable need to reform and integrate the existing centres with other services provided to women by provincial governments, closure of the centres is not an option'.

According to a newspaper report (Nov 14) and in direct contradiction to the advice of the government's own commission, many of these centres are now face impending closure. It seems this government is intent on acting as its own worst enemy and remains a victim of paralysis in decision-making. The centres have outstanding dues owed by the federal government accumulated prior to the Devolution of the Ministry of Women's Development (MoWD) in June 2011. This has been exacerbated further due to the unwillingness of the provincial governments to release subsequent funds to ensure the survival of the centres, post-devolution.

The outright refusal of the Punjab government to 'own' the Punjab SBBWCs and now the impending closure of the SBBWCs in Sindh, means the discontinuity of one of the few social services that were still functioning, however imperfectly, in the country.

The efforts of the minister at the Women's Development Department in Balochistan and the lobbying of the manager and staff in the Quetta centre have resulted in an admirable resolution of the crisis in their province for the time being. Khyber Pukhtunkhwa's fate hangs in the balance. The centres have survived despite a variegated history. Set up first as the Women's Crisis Centres (1997), these centres changed ideologically when they were re-organized as Family Protection and Rehabilitation Centres under the Musharraf regime in 2005.

Contrary to the news report (Nov 14), these centres were not renamed the Shaheed Benazir Bhutto Women's Centres by the Sindh government after devolution this year but in fact as soon as the PPP government came into power in 2008.

Since they now function only as a referral service, this has limited the possibilities of what these centres could reasonably deliver. However, as the NCSW study shows through empirical and ethnographic evidence, these centres are 'crucial first-stop referral centres that identify the victim, her needs, counsel her, document the nature of the case and refer her to the appropriate authorities. This enables a quick, needs-based response. Other institutions, such as the police, are only required to register cases and dar ul amans simply offer shelter to court referred cases and are commonly considered to function as "sub-jails". Edhi centres are charity based rather than professional resolution centres; faith based private shelters have their own notion of destitute women or are not neutral in their approach to rehabilitation. Private/NGO shelters are few and do not have the outreach or capacity as government institutions.'

Under the federal set-up, these centres have historically suffered the usual bureaucratic inefficiencies, such as late release of funds, as well as no meaningful monitoring nor comprehensive in-depth evaluation. Some NGOs, such as Rozan and AGHS/Dastak, have worked with the MoWD in improving the standard operating procedures at the centres. However, the real crisis came to a head after the devolution of the Ministry of Women's Development in June 2011.

Devolution signalled the rude awakening over the dangers of running women's policies as never-ending 'development schemes' rather than as permanent policy with regularised staff. Some critics observe that despite high moments, the MoWD ran for too long as a glorified NGO and from project to project. Since they were not permanent schemes, the SBBWCs in three provinces hung in limbo as governments attempted to absorb them into the provincial administrative set-ups. Punjab, meanwhile, refused to own the SBBWCs and made a technically reasonable, if misguided, case over the historically disinterested attitude of the federal government itself with regard to these centres.

Interestingly, the women MPAs of the Punjab assembly have supported and continue to lobby for the case of retaining the SBBWCs, despite disowning by the male leadership of their provincial government. This is a remarkable show of political maturity and autonomous women's politics. But they lack support from other women, as well as lazy or disinterested male colleagues.

After Punjab's refusal to take charge, the Ministry of Human Rights in Islamabad has agreed to tide over the Punjab centres until June 2012. But others are questioning why such anti-women political decisions by the Punjab government are being rescued and rewarded by the federal government. Such exceptionalism does not bear well for the future of provincial autonomy or for long-term political harmony amongst provinces.

In many ways, these centres are examples of the kind of institution building that is often endorsed in theory by analysts in Pakistan. The administrative investment towards improving these centres has included a partnership with the private/NGO sector, which has worked quite well in most cases. The centres have survived and been supported by successive governments who despite oppositional policies, have always retained the centres in view of their services.

The SBBWCs have also established strong community linkages, especially during the period when the local government system was active and the nazim/councillors worked closely with them in rehabilitating women seeking resolution of their cases. Although a detailed cost-effective

evaluation has not been done, a cursory calculation suggests the centres offer a service that is more than cost-beneficial.

The SBBWCs act as the first interface for walk-in or referred victims of violence and those suffering post-traumatic experiences who need a very sensitive and responsive approach, rather than the more officious police response or matter-of-fact institutional response of dar ul amans.

Also, the services that the SBBWCs offer, aim at resolution, not institutionalisation of victims. These centres offer immediate and independent legal aid rather than court-referred legal assistance, which is what dar ul amans do. The myth that these centres duplicate the work of the dar ul amans is something the Punjab government has to stop hiding behind.

For the usual critics, who point out the proportionately low number of women who access such services, the NCSW study would be educational. Women survivors of violence only tend to approach such services when the male dominated community justice system fails them. They know that to breach the community's norms and defy male determined arrangements, such as forced marriages, domestic and reproductive exploitation comes at a huge price and they can never go back. That's the kind of brave women who seeks the state's refuge.

The voices of the beneficiaries in this study show that women survivors are showing a preference to circumvent community mediation and approaching the state institutions directly, such as the courts or the SBBWCs. This is significant because it shows faith in the state.

The NCSW study also provides alternative models that have evolved by way of the Panah shelter in Karachi and the lessons that can be imbibed from Dastak in Lahore or Mera Ghar in Peshawar. The point is that these running institutions can be improved and upgraded by sharpening and even extending services through linkages with lady health workers, other dispute-resolution efforts and documentation of women survivors' experiences. But to shut down this network is simply a sign of defeat and lack of commitment to women's issues.

This is an important electoral matter that the provincial governments can legitimately exploit rather than succumb to short-term financial obstacles that are usually deliberately created by disinterested and myopic male bureaucrats.

Zia, Afiya Shehrbano, 'Shutting the Doors', *The News*, Karachi, 21 November 2011.

International Development, vol. 11, no. 2, 1999; Zaidi, S. Akbar, *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999); McCarney, Patricia, L. (ed.), *Cities and Governance: New Directions in Latin America, Asia and Africa* (Toronto: Centre for Urban and Community Studies, University of Toronto, 1996); McCarney, Patricia, L. (ed.), *The Changing Nature of Local Government in Developing Countries* (Toronto: Centre for Urban and Community Studies, University of Toronto, 1996); and Jean Dreze and Haris Gazdar, 'Uttar Pradesh: The Burden of Inertia' in Jean Dreze and Amartya Sen (eds.), *Indian Development: Selected Regional Perspectives* (New Delhi: Oxford University Press,1996).

In addition, recent publications worth consulting include those cited in chapters 19–23 as many now implicitly or explicitly talk about governance and institutional issues. Almost all publications of the World Bank, Asian Development Bank, UN publications etc. carry analysis which have an institutional component. In the context of Pakistan, the following publications will be useful: S. Akbar Zaidi's, *Transforming Urban Settlements* (Karachi: City Press, 2000) on The Orangi Pilot Project; Arif Hasan's, *The Unplanned Revolution* (Karachi: City Press, 2002); and Shahrukh Rafi Khan's, *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999).

Given the diverse contents of this chapter, the Notes provide the most appropriate reading for the different sections. However, the World Bank's *Women in Pakistan: An Economic and Social Strategy* (Washington DC, 1989) is a useful text on the extent of gender inequality in the country. The paper by S. Akbar Zaidi, 'Gender Perspectives and Quality of Care in Underdeveloped Countries: Disease, Gender and Contextuality', *Social Science and Medicine*, vol. 43, no. 5, 1996, presents a good summary of many of the issues concerning gender discrimination, and offers a radical critique of the most common arguments. The Mahbub ul Haq, Human Development Centre's, *Human Development in South Asia 2000: The Gender Question* (Karachi: Oxford University Press, 2000), is an excellent and highly recommended publication which looks at women in Pakistan and compares them to those in the South Asian region. Tariq Banuri's edited *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Karachi: Oxford University Press, 1998), is also a useful reference for many of the issues in the social sector. See also S. Akbar Zaidi's *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government*, Oxford University Press, Karachi, 1999.

On the environment, by far the best volume is the IUCN's *Pakistan National Conservation Strategy*, Karachi, 1992, along with its ancillary volumes and documents. See also Arif Hasan's and Ameneh Azam Ali's *Environmental Repercussions of Development in Pakistan*, OPP-RTI, Karachi, 1993. Shaheen Rafi Khan and Shahrukh Rafi Khan's, 'Environment: Some Key Controversies', in Shahrukh Rafi Khan's edited, *Fifty Years of Pakistan's Economy*, Oxford University Press, Karachi, 1999, should also be consulted. See also, Shahrukh Rafi Khan, Foqia Sadiq Khan, and Asim Sajjad Akhtar, *Initiating Devolution for Service Delivery in Pakistan: Ignoring the Power Structure* (Karachi: Oxford University Press, 2007); and Social Policy and Development Centre, *Devolution and Social Development: Annual Review 2011–12* (Karachi: SPDC, 2012). An excellent recent critique on participation and on the so-called new paradigm is Ghazala Mansuri and Vijayendra Rao's *Localizing Development: Does Participation Work?* (Washington DC: World Bank, 2013).

Box 20.9

Civil Society's Failures

S Akbar Zaidi argues that not all community participation or civil society initiatives are a success.

Economists know about what they call 'market failure' as well as 'government failure', where neither institution in its entirety, for a large number of well-recognized reasons, has been able to deliver development. Issues of coordination, asymmetric information and inequality, are said to affect both avenues of development. Such theoretical understanding and practical experience, gave rise to the need for 'civil society' to emerge and resolve such failures and offer itself as a developmental alternative, and a much better one than either.

Assumptions have been made that groups of people, ranging from village communities, urban neighbourhood councils, school associations, and water user groups, work for the common interest of their collective members, benefitting all. A sense of egalitarianism has seeped into the general framing of civil society's efforts to provide development, and this has given rise to a vast global movement of self-help, or NGO-led development models, where NGOs and CBOs have replaced governments or become contractors for them. The surprising thing is that there has been very little empirical evidence, until now, that is, which examines the contributions of civil society to development, and the conventional wisdom endorses the broad, feel good sentiment, that civil society does good, a great deal of good, for communities, and that it is a far better alternative to either the government or the market.

In a recent book produced by two economists at the World Bank, the model of civil society development has been empirically challenged.[1] Even though the World Bank has allocated $85 billion to local participatory development over the last decade, there has been little detailed investigation as to whether this participatory model of development works well. Ghazala Mansuri, a former graduate of Karachi University, and her colleague Vijayendra Rao in Washington, have looked at over 500 empirical studies of participatory development interventions, and their findings offer a loud wake-up call to all civil society developmental enthusiasts.

The wide-ranging notion of civil society needs to be bifurcated into at least two broad categories, with advocacy-related, organic, participatory movements, such as those which overthrew military dictatorships or the Soviet regimes of the 1980s leading to widespread political and social change, from what the authors call 'induced participatory interventions', which work largely for develeopmentalist outcomes and goals. It is this latter, the so called NGO or community-based world, which comes under careful scrutiny by the two economists, where 'fads, rather than analysis, tend to drive policy decisions on participatory development'.

They find that many of the problems which afflict government and market failure, also affect civil society initiatives, and that inducing civic empowerment may not be a better choice than a market-based strategy or even one which strengthens the role of centralizing bureaucrats. Groups do not always work collectively, as one has assumed, there is a great deal of differentiation within such so called communities, where differences of class, gender and status affect outcomes and lead to elite capture.

Their research shows that participants in civic activities 'tend to be wealthier, more educated, of higher social status, male, and more politically connected than nonparticipants'. Given such existing divisions in all communities, they feel that there is little 'evidence that induced participation builds long-lasting cohesion, even at the community level', and many existing social divisions are actually reinforced. The poor benefit less from participatory processes than do the better off and, despite their focus on poverty alleviation, 'community-based development efforts have had a limited impact on income poverty'.

One of the assumptions of this participatory development, whether of the NGO kind or of decentralization, is that it improves development outcomes and that there is likely to be equitable development. Looking at a wide spectrum of initiatives, the authors find again, that decentralized projects lead to local capture by the elite and the better-off, and often projects benefit the better-off than the poorer communities for whom they were initially intended. Especially women and minorities, who are excluded anyway, continue to be discriminated against in such so called participatory, localised, decentralized, developmental initiatives.

What is not surprising is that civil society has failures embedded in its developmental model just as much as government and markets do. What is surprising is that there has been little careful evaluation of civil society efforts and that they have been promoted by donors, aid-giving foundations, communities and even governments. One of the key findings from this research is the not surprising finding, that repairing civic failures requires reducing social inequalities.

The state, rather than the market or civil society, is perhaps best equipped to address such inequalities and, importantly, as we have seen around the globe, the state does not need to be democratic to do so. The evidence provided by these authors 'overwhelmingly suggests that effective community-based interventions have to be implemented in conjunction with a responsive state'.

Source: Zaidi, S Akbar, 'Civil Society's Failures', *Dawn*, 20 August 2013.

1 *Localizing Development: Does Participation Work?* (Washington DC: World Bank, 2013).

Appendix 20.1

The Gender Trap

The following article examines the reasons why women are discriminated against and argues that most of the causes for gender discrimination are structural and deep-rooted. The article makes the point that marginal changes will be ineffective, and that in order to address and reverse gender discrimination, structural changes at the societal and economic level are essential.

There is little doubt that the position and status of women in almost all societies is far worse than that of men. Sexual and domestic violence, added to more subtle forms of oppression and deprivation, are especially prevalent in underdeveloped countries. Higher morbidity and mortality rates, poor health, low levels of education and literacy, and few opportunities for gainful employment are among those factors which restrict the development and fulfilment of the potential of women. By any yardstick, the position of women is far worse than that of men.

Much blame has been heaped on men, or patriarchy, for causing this system of inequality, and very little on the social, economic and political structures in which both men and women live and co-exist. While numerous researchers and scholars—almost all of them women—have identified the extent of gender inequality in the third world, and have made suggestions for redressing these inequalities, their well-meaning recommendations have been largely ineffective. And this is to be expected, because unless the material conditions and causes of gender inequality are evaluated and understood most attempts at reform will fail.

The evidence in support of the fact that women are discriminated against is extensive and indisputable. Numerous studies have shown that low levels of education and training, poor health and nutritional status, and lack of access to resources affect the quality of life for women. The allocation of resources at the household level also affects the nature and quality of women's health and their lives. At the same time, norms and customs such as female seclusion and the resulting lack of interaction with the outside world have also had a negative impact on the economic situation of women.

In addition, procreation with its consequences on the well-being of women, is considered in many underdeveloped societies to be a social activity influenced by cultural norms which encourage high fertility rates, a custom which no household desires unilaterally to break. High fertility, high rates of illiteracy, a low share of paid employment and a high percentage of women working at home for no pay seem to coexist together, all aggravating the situation.

Work on the economic and social status of women in South Asia has shown that 'the gender gap in the ownership and control of property is the single most critical contributor to the gender gap in economic well-being, social status and improvement' in countries where property rights are governed by laws usually influenced by religious mandate. In many countries, male domination has become culturally sanctioned and gender based subordination is reinforced by religious systems. This sort of thinking has become ingrained in the consciousness of both men and women and is viewed as a natural corollary of the biological differences between them. Moreover, concepts of gender roles, desirable behaviour and appropriate expectations are learnt from a very early age, so much so that gender becomes an integral part of a person's identity and gender roles are seen to lie at the centre of people's cultural and religious heritage. As a result, in many countries there is a 'culture against women' in which women are socialized to sacrifice their health, survival chances and life options.

However, all these factors which affect women, their health and quality of life need to be seen in a somewhat broader context. The lack of access to resources, which is said to affect the status of women more adversely, is highly dependent on one's social and economic position. For instance, nutritional deficiencies in women, which are significant in much of the third world, are highly skewed towards the poorer women in these countries. It would be difficult to argue that class differentiation does not determine disease and health patterns in any country, especially in underdeveloped countries where this differentiation is more acute. Rich women in even the poorest of underdeveloped countries do not face most of the problems highlighted by the research on gender and health. Not only are richer women better off by far in terms of most social indicators than their poorer sisters, but they are also far better off than poorer men. Within societies, one's position—whether male or female on the social and economic ladder—determines access to resources, and hence well-being. Moreover, across nations there is a great deal of evidence which suggests that countries with higher levels of economic development, industrialization and urbanization are more likely to experience greater gender equality. With increased economic growth there is a likelihood that gender equality will also increase.

There is no denying the fact that legal structures and rules discriminate against women and need to be changed. However, the political economy of legal systems ensures that archaic and discriminatory legal practices are maintained indefinitely. The economic and class composition of society protecting a particular configuration of property rights warrants a particular legal structure. More often than not, a change in those property rights structures creates changes in legal structures. As such, to expect that substantial legal reforms will take place in society without a transformation of social, economic, property and political rights is a little simplistic. Moreover, even when the laws do exist, social and economic structures intervene. For example, gender equality in the legal right to own property does not guarantee gender equality in actual ownership, nor does ownership guarantee control. Also, traditions and customs continue to disregard laws, with many discriminatory and illegal practices being sanctified by religion.

Such values and norms which create and justify gender bias against women are the least likely to undergo change via direct intervention. Ancient traditions and customs survive even major economic transformations and epochs, because

they are so ingrained in the social and cultural fabric of society. To challenge and question what are often defined as religious guidelines is perceived as betrayal of one's religion, community and culture.

When gender inequality is caused by values, norms, customs and religion, the process of change is made even more difficult and complicated. If religion or custom are responsible for, say, the seclusion or exclusion of women from the public and hence economic domain, no attempt to increase women's involvement in the public sphere will end the resulting gender bias, unless the foundations of the discriminatory practices are uprooted. Within existing social, economic and property structures this will be unlikely.

The key argument being made here is that while gender inequalities are substantial, they are a symptom of a social and economic structure which produces or results in those inequalities. Hence, any attempt to improve the status of women without questioning, challenging or changing the existing structure will be ineffective.

Feminists and women's groups strive for strategies to reduce gender inequality. They demand more equality and greater control over their lives and devise opportunities and insist on policies that will improve their well-being and absolute and relative status. But why must these initiatives be restricted to women alone? Just as much as women want equality and greater control over their lives, so do men, of all classes. But just as poorer women suffer from greater lack of control over their lives, so do poorer men. Thus, if control is dependent on income, wealth, class or location in the social matrix, it is unlikely that this control will be achieved without addressing the material conditions which affect the extent of control.

Much of the well-meaning research on gender discrimination, and ways to address and reverse that discrimination, ignores the existence of classes or social and economic differentiation. It omits an analysis of power relations, power that is usually though not exclusively articulated through an individual's or group's position in the social and economic hierarchy. Not all women are equal and hence to speak about the problems of 'women' obfuscates the extensive differentiation between different classes of women who are affected differently by discrimination. Furthermore, the same structural differentiation in society affects men of the poorer classes equally. In fact there may be more similarities between men and women of similar social and economic backgrounds than between members of the same gender with significantly different social and economic positions. The dominant thinking addressing the issues of gender ignores the social and economic construct of differentiation, as well as the similarities between the two genders.

Women's rights and the struggle for greater equality and opportunities cannot take place outside the overall social and political matrix which constitutes that particular society and defines their position in it. There can be no denying the numerous examples of successful interventions that have resulted in greater equality for women at a micro and project level. But to effectively change the position of women in the economic and social matrix, and to increase and improve their status, what needs to be dealt with are the structures which cause the inequalities in the first place, be they economic or spiritual. Since men too are victims, though certainly to a lesser degree, of the structures of society, there is also a need to incorporate men and their role in changing the inequitable system which distributes resources inequitably.

Almost all evidence from studies related to health, education and economic development shows convincingly that women are the very central, if not the most critical, component of the equation. While the western developed countries have only recently discovered the role of women in development, little do they know that in underdeveloped countries women are never 'outside' development, for their very existence and survival and that of their family and often of the entire country depends on their being 'in' development. This is precisely why their role and position cannot be analysed and examined separately and in isolation, without reference to, and in conjunction with, men and the broader social structure in which they coexist.

Feminist groups and women's activists have focused exclusively on the role of women alone. Possibly, it is time to bring both men and the social structure within the realm of analysis and practice. This at least is a minimum condition for greater equality for all, women and men.

Source: Zaidi S. Akbar, *The Herald*, April 1996.

Appendix 20.2

Community Participation and NGOs: Some Experiences from the Health Sector

Community participation seems to be such an obvious choice as a vehicle for development-related projects. Why, then, does it fail? Here are some reasons.

On the face of it, community participation seems like a desirable component to any development policy and there is a growing belief that as long as the 'community' is involved, development will be somewhat better and more effective. However, numerous experiences have shown that the imposition of community participation on health structures has had disastrous consequences on the health programme and on the welfare of the affected people. The 1978 Alma Ata Declaration of Health for All by the year 2000 which emphasizes primary health care, also makes a universal declaration for community participation which forms a cornerstone of providing health for all. Both WHO and UNICEF, and now the World Bank, have consciously, and often aggressively, highlighted the need for the participation of communities. This over-enthusiasm, often in disregard to specific cultural, social and political conditions, has in many cases caused the participatory approach to fail.

Lynn Morgan in her study on primary health care [PHC] in Costa Rica, one of the world's success stories in PHC, argues that 'Costa Rica's experience with community participation in health exemplifies the complexities and social contradictions that emerge when a small, economically dependent country feels the need to adopt externally-sanctioned models when structuring rural health services.' She argues that 'participation was a concept introduced by the US and promoted by foreign aid agencies to promote a western democratic political ideology' and the international agencies 'justified community participation in health more because they wanted to reinforce the symbolic identification of 'health' with 'democracy' than because they knew that community participation would improve health'. WHO and other international agencies made community participation a pivotal strategy 'because it satisfied politico-ideological needs. The international agencies needed a cooperative non-confrontative approach to address issues of poverty and inequitable distribution of wealth.' The community participation component in Costa Rica's rural health programme lasted a mere four years, as officials quickly realized how the objective had failed and let the successful rural health programme continue without any forced participation, which, in the first instance, had been included only on the insistence of international organizations following Alma Ata in the period 1978–82. Interestingly, Morgan argues that the international organizations themselves, discouraged by the results of the exercise of participation, withdrew their insistence, but she argues, 'Costa Rica's willingness to comply with international mandates suggests that the government would have continued to support community participation if the agencies had continued to deem it necessary.'

The case of the Dominican Republic is somewhat similar where a primary health care programme was also short lived, as its development and dissolution formed part of US foreign policy. Whitford argues that 'the Dominican institutionalization of primary health care succeeded in meeting political needs, even as it failed to raise health levels'. Its broader purpose was to counter 'Castro-communist' policies and not necessarily one of attacking morbidity and mortality. As US foreign policy particularly favoured the Dominican Republic, substantial assistance in the health sector came from USAID, the World Bank, the Inter-American Development Bank, as well as other health and development agencies. The result of the imposition of the primary health care scheme was that since it was a foreign model, it resulted in intensifying class, status and regional differences. Whitford believes that the model for the Dominican primary health care system should 'have been created in response to host country needs, abilities, and capabilities; it should not have come from a lender-country formula'. In the case of Nepal, where also due to the thinking of the international agencies, Judith Justice has found that the primary health care approach was 'accommodated' in the health care system, and the results were far from positive.

Also in Nepal, Linda Stone's work has shown how the focus on community participation 'appears to be an attempt to promote the western cultural values of equality and self-reliance (values not shared by the local population), while ignoring alternative values and perceptions of how development might work in rural, non-Western societies of developing countries'. In Nepal and other south and south-east Asian countries, primary health programmes have been ineffective 'because they were designed to meet the needs of various health bureaucracies rather than the needs of local villagers'. Antonio Ugalde has also reached similar conclusions where he has shown how the concept of community participation in Latin America is based on the needs, demands, insistence, and direction, of international organizations.

Other than the problems with the imposition of community participation in primary health care on the insistence of donors, there are numerous other problems within local hierarchies which frequently subvert any possible gains to be made by participation.

Community participation has been seen as a means of control and manipulation of the people, the supposed beneficiaries of the process of participation, by politicians, bureaucrats and technocrats. Cultural concepts within communities and of those who locally implement primary health care and participation have been seen to make such programmes dysfunctional. Urban trained professional workers who are requested (or forced) to work in rural primary health care settings are unable and/or unwilling to work in a system which they are neither trained for, and nor particularly like; their training has made them competent to work in urban hospital settings, not in the community. Conflict is seen to emerge within and around community projects when the local social structure impinges on the proper functioning of (democratic) community participating. Additionally,

government bureaucrats are faced with a two-edged sword regarding community participation in development related schemes: if a scheme works due to 'self-help' or on the community's combined effort, government is relieved of providing these services and can concentrate on a different set of priorities; however, if schemes continue to work and more self-reliance, political consciousness and 'empowerment' takes place, and people begin to get collectivized and demand better facilities, further pressure is put on the government to deliver. Similarly, the failure of community projects would mean to some members of government, that the people are still dependent on government and cannot manage without it; the government would, however, have to cope with increased demands on its resources.

Non-Governmental Organizations (NGOs)

The recent mushrooming of all sorts of voluntary agencies and NGOs—one observer counted 700 'missionaries of progress' and 50 donor agencies in Kahtmandu in 1986, including a maritime agency which was 'of the opinion that landlocked Nepal ought to own a cargo vessel moored across India, in Calcutta'—has reinforced the view that community participation is the key to progress and development. It is readily believed, especially by those working for and involved with NGOs, that the solutions to the problems of the poor in the Third World rest in the arms of these NGOs. Strong claims have been made on behalf of NGOs, claims which range from those that suggest that NGOs are the truest forms of democracy, to those that they are responsible for a new development vision.

While numerous local voluntary groups and NGOs have proven effective in their attempts to improve the well-being of their reference group, many, especially those who have had to depend on foreign donors making often considerable contributions to the cause of their choice, have had to compromise to rules and concepts which are unworkable and/or alien to the perceived beneficiaries' needs. Some NGOs have been set up by organizations like the Ford Foundation and USAID and this has resulted in a relationship of severe dependence of local NGOs on external agencies.

One observer has argued that NGOs in some countries have been taken over by the élite: 'Expensive conferences are arranged all over the world on NGOs. Young men and women who look good and talk good are now seen in five star lobbies talking participation with donors. Lengthy consulting reports at highly inflated rates are prepared for NGOs by NGOs. The upper class has shown its alacrity yet again. They are taking full advantage of the new and generous opportunity being offered by the NGO.' Those NGOs which are dependent on foreign funding often have to provide reports which continue to prolong their own existence. Since many foreign donors are not particularly familiar with local conditions, progress reports are often 'fudged' and fabricated to justify further funding. Bratton argues that 'since all African NGOs rely heavily on donated funds, NGO leaders must cultivate more productive relations with the organizations and individuals who provide their resources'. With growing amounts of international aid and assistance being channelled through NGOs, the blossoming of the voluntary sector is bound to continue. And as its role and presence grows, its interests will get further entrenched.

Source: Zaidi, S. Akbar, 'Planning in the Health Sector: For Whom, by Whom?', *Social Science and Medicine*, vol. 39, no. 9, 1994, 1389–91.

Appendix 20.3

NGOs for the Élite

Abdus Samad takes a rather critical look at NGO culture in Pakistan:

> The Pakistani élite has been a wonderful survivor in Pakistan. It has adapted itself to changing incentives very well. No matter what government is in power or what the new thinking of the expatriate expert, you can be sure that members of our élite will be drawn to money, funding and power as honeybees are to honey. This class has, through our brief history, shown itself to be very agile in discovering the latest trend for acquiring fame and fortune. The middle classes that attempt to ape the élite, unfortunately, are always a little late in catching the trend and arrive largely after the élite has moved on. Or perhaps the élite moves on when the lesser classes arrive.
>
> In the fifties, the civil service was the only game in town. It was the only way for any young man to achieve distinction, power and moderate wealth in the newly formed country. Young men from the élite would obtain the best of grooming and education at home and coast into the academy. All they had to do was look good, talk good, and rule. No burden of serving the people was placed on them. The government was there to serve them and not the other way around.
>
> By the late sixties, the lower classes had caught on and their young men, driven by ambition, and by the dint of effort, began to compete for the civil service. Local institutions, that groomed the élite, became accessible to all and the relatively poor and less privileged began to flock to them. The distinction between the ruler and the ruled was being eroded.
>
> This was an easy matter to deal with. The upper classes simply abandoned those institutions and started to send their children abroad. The result was fortunate for the upper classes in two respects. First, the polish added on by Oxbridge and the like, maintained the distinction between the high born and the low born. Second, this distinction could be further sharpened by allowing the domestic institutions to fall into a state of rapid decline since the élite needed them no longer.

However, the onslaught of the lower classes for some form of power sharing or democratization could be resisted no longer. Succumbing to this, Bhutto, in 1973, proceeded to reform the civil service in a manner that ended the éliteness of the club forever. The lower classes invaded the club in large numbers.

The élite responded by abandoning the civil service. It is interesting to observe that the socio-economic background, the education, as well as the extent of polish, of the average recruit changed dramatically during this period. The élite having abandoned the system allowed it again to deteriorate rapidly.

However, an alternative had to be found for the polished and educated young men of the élite. Fortunately, the multinationals saw the opportunity as well as the tremendous economic advantage of exploiting the powerbase of the élite and its princes. Thus, in the mid-seventies, we saw that the élite children were employed by multinational companies. Interestingly enough, the very same individuals who had been preparing almost their entire life for the big civil service exam, suddenly forgo the exam and start beating a path to the door of the BCCIs, Citibanks, Banks of America, ICIs etc. The multinational, in turn, hires them, treats them in a manner that is in keeping with their stature. Of course, these foreign firms exploited the contact base, élite position in society, as well as the better education, of their new hirees from the élite classes for their own advantage in Pakistan. Consequently, we see unprecedented growth of these firms and their profits in Pakistan during the seventies and eighties.

Meanwhile, during the roaring eighties, a new trend started setting in. The deterioration of the civil service and the public sector had reached an advanced stage. Public sector personnel became both corrupt and incompetent. The government became virtually paralysed and had only one unabashed aim—to confer rents and benefits on the élite. The truly well-connected member of the élite could safely use the government institutions to his own advantage. The result: a) rent-seeking which earlier was in its infant stages now is a growth industry, and b) white collar crime is now in fashion. Distributor/agents of foreign companies specialise in selling any and all equipment to the government at highly inflated prices. Individuals from the élite classes now turn to obtaining loans from the nationalized financial institutions with every intention of not returning them. Scams such as finance companies and the cooperatives are run with impunity and with absolutely no fear of retribution.

Unfortunately, the roaring eighties came to an end. BCCI was caught out. The phenomenal pace of growth of the multinational firm could not be maintained forever. Petrodollars were gone and the bipolar world had made its way into the history books. The government had borrowed too much and was being forced by international agencies to curb its spendthrift ways. This meant that multinational jobs were relatively scarce now, bank loans were more difficult to obtain, and selling worthless equipment to the government at inflated prices was now more difficult.

As luck would have it, an opportunity again presented itself to the élite. Donor agencies and the development-oriented 'thinkers' (henceforth DOT) had long relied on the government for the development miracle. Frustrated with the dismal performance over the years, they were seeking an alternative approach but one that would still limit the role of the private sector (for the private sector and the DOT are mutually hostile). The new approach that they thought up was based on the notion of 'participation' where citizens were only to be consulted in decision-making. Of course having consulted with the people, the government would continue to spend money on behalf of the people, awarding the contracts to its favourites.

The modes of participation remained to be determined. Since the average DOT is suspicious of the private sector and profit, he dreamed up the nearest equivalent to the government—a non-profit organization—as his basic unit for this participation. As the DOT desired, the NGO, like the government, is responsible to no one. So long as funding is available, the NGO can continue to do as it pleases with absolutely no regard to private or social productivity.

Pleased with this line of reasoning, the donor agencies encouraged rapid growth of the NGOs. Funding was easy and the educated upper classes cashed in. The living rooms of almost every house in Gulberg, Defence and the Fs and Gs [F and G sectors] of Islamabad were quickly converted to NGOs. Once a donor is convinced, there is no looking back. An NGO is born. Its health and growth is determined only by the glibness of its parent.

The decade of the NGOs is here. Expensive conferences are arranged all over the world on NGOs. Young men and women who look good and talk good are now seen in five star hotel lobbies talking participation with donors. Lengthy consulting reports at highly inflated rates are prepared on NGOs by NGOs. The upper classes have shown their alacrity yet again. They are taking full advantage of the new and generous opportunity being offered by the NGO. Like before, the bill for this high living by means of the NGOs will be paid for by the people of Pakistan when the loans of the donors, financing these organizations, are called.

To me the only remaining question of interest is: After the NGOs what will be the next goose that lays the golden eggs for the élite?

Source: *The News*, Karachi, 18 July 1993.

Notes

1. The last full MDG Report for Pakistan was completed in 2010 and covered the period 2006–10. See, Centre for Poverty Reduction and Social Policy Development, *Pakistan: Millennium Development Goals Report 2010* (Islamabad: Planning Commission, Government of Pakistan, August 2010). Most of the discussion and the tables are drawn from this report. The final Report was completed and published by the Centre for Poverty Reduction and Social Policy Development, with considerable input by this author. Some of the material used here in this Section, is drawn from earlier drafts prepared for the Centre for Poverty Reduction and Social Policy Development, and all of it may not have found its way into the final Report, although much did.
2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid.
6. Ibid.
7. Ibid.
8. World Bank, *Women in Pakistan: An Economic and Social Strategy* (Washington DC: World Bank, 1989), (iii).
9. Cornia, Giovanni, 'Accelerating Human Development in Pakistan', in Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992), 101.
10. World Bank, op. cit., 1989, (xiv).
11. These observations are extracted from World Bank, op. cit., 1989; World Bank, *World Development Report 1995* (New York: Oxford University Press, 1995); and UNDP, *Human Development Report 1995* (New York: Oxford University Press, 1995).
12. See also Zaidi, S. Akbar, 'Gender Perspectives and Quality of Care in Underdeveloped Countries: Disease, Gender and Contextuality', *Social Science and Medicine*, vol. 43, no. 5, 1996.
13. Ibid.
14. World Bank, op. cit., 1989.
15. Ibid. 41.
16. Ibid.
17. Ibid. 48.
18. Zia, Afiya S. and S. Akbar Zaidi, 'Democracy and Devolution, *Dawn*, Karachi, http://archives.dawn.com/archives/30750
19. This section makes extensive use of IUCN, *The Pakistan National Conservation Strategy* (Karachi, 1992), and Hasan, Arif and Ameneh Azam Ali, *Environmental Repercussions of Development in Pakistan* (Karachi: OPP-RTI, 1993).
20. World Bank, op. cit., 1995, 170.
21. IUCN, op. cit., 1992, 10.
22. Ibid. 21.
23. Hasan Arif and Ameneh Azam Ali, op. cit., 1993, 47.
24. Ibid.
25. See, for example, Zaidi, S. Akbar, 'The Structural Adjustment Programme and Pakistan: External Influence or Internal Acquiescence?', *Pakistan Journal of Applied Economics*, vol. X, nos. 1 and 2, 1994(a); Zaidi, S. Akbar, 'Planning in the Health Sector: For Whom, by Whom?', *Social Science and Medicine*, vol. 39, no. 9, 1994(b); Zaman, Arshad, 'Sustainable Development, Poverty and Policy Adjustments: Linkages and Levers for Change', mimeo (Canada: International Institute for Sustainable Development, 1993); Banuri, Tariq, *Economic Liberalization: No Panacea* (Oxford: Clarendon Press, 1991); Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992), (a).
26. Zaman, Arshad, op. cit., 1993.
27. Leftwich, A., 'Governance, Democracy and Development in the Third World', *Third World Quarterly*, vol. 14, no. 3, 1993.
28. Zaidi, S. Akbar, op. cit., 1994(b); Zaman, Arshad, op. cit., 1993.
29. Government of Pakistan, Planning Commission, *Eighth Five Year Plan (1993–8): Approach Paper* (Islamabad, 1991),(a), 9.
30. Ibid. 11.
31. Ibid. 8.
32. Sayeed, Asad, 'Social Sector Development and the Social Summit', mimeo (Karachi: Social Policy and Development Centre, 1996), 1.
33. See, Leftwich, A., op. cit., 1993, and Zaidi, S. Akbar, 'Urban Local Governance in Pakistan', in Islam, Nazrul and M. M. Khan (eds.), *Urban Governance in Bangladesh and Pakistan*, Centre for Urban Studies (Dhaka: University of Dhaka, 1997), (a).
34. For an excellent summary and critique of governance, see Leftwich, op. cit. 1993.
35. Khan, M. M., 'Governance: A Conceptual Framework', mimeo (Dhaka: Global Urban Research Initiative, Centre for Urban Studies, Department of Geography, University of Dhaka, not dated), 1.
36. Ibid.
37. Leftwich, A., op. cit., 1993, 610.
38. World Bank, *Governance and Development* (Washington DC: World Bank, 1992).
39. M. Halfani et al. 'Towards an Understanding of Governance: The Emergence of an Idea and its Implications for Urban Research in Developing Countries', mimeo, 1994, 4, subsequently published in McCarney, Patricia, L., op. cit., 1996(b).
40. Banuri, Tariq, 'Just Adjustment: Protecting the Vulnerable and Promoting Growth', *Pakistan Development Review*, vol. 31, no. 4, 1992(a), 685–6.
41. Khan, M. M., op. cit., 1.
42. Cornia, Giovanni, 'Accelerating Human Development in Pakistan', in Banuri, Tariq (ed.), *Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992), (b), 105.
43. Ibid.
44. Ibid.
45. Sayeed, Asad, op. cit., 1996, 13–14; see also Zaidi, S. Akbar, op. cit., 1996(b).
46. Cornia, Giovanni, op. cit., 1992, 106.
47. Ibid.
48. This section makes extensive use of Mumtaz, Khawar, 'NGOs in Pakistan: An Overview', in Banuri, Tariq, op. cit. 1992(b). However, for a critique of NGO activities, see Zaidi, S. Akbar, 'NGO Failure and the Need to Bring Back the State', *Journal of International Development* vol. II, no. 2, 1999(a). Zaidi, S. Akbar, *The New Development Paradigm: Papers on Institutions, NGOs, Gender and Local Government* (Karachi: Oxford University Press, 1999), (b).
49. Mumtaz, Khawar, op. cit., 129.
50. Ibid.
51. Ibid. 134–5.

52. Banuri, Tariq and Moazam Mahmood, 'Learning from Failure', in, Banuri, Tariq, op. cit., 1992(b), 117–18.
53. Ibid. 118.
54. Sayeed, Asad, op. cit., 1996, 19.
55. See Zaidi, S. Akbar, op. cit., 1996(b); Zaidi, S. Akbar, op. cit., 1999(a), and Zaidi, S. Akbar, op. cit., 1999(b).
56. See Zaidi, S. Akbar, op. cit., 1994(b).
57. See also Zaidi, S. Akbar, op. cit., 1996(b), and Zaidi, S. Akbar, op. cit., 1999(b).
58. Dreze, Jean and Haris Gazdar, 'Uttar Pradesh: The Burden of Inertia', mimeo, 1996, 47. This paper was published in Dreze, Jean and Amartya Sen (eds.) *Indian Development: Selected Regional Perspectives* (New Delhi: Oxford University Press, 1997).
59. Ibid. 67.
60. Ibid.
61. Ibid. 71.
62. Ibid. 84.

In the case of health services and health providers, there has been a consistent increase in facilities at all levels as well as in health and medical personnel. All facility-to-population ratios, such as that of beds, doctors, etc. have improved over time. There has also been an increase in access to health services for the whole population. However, public health services are deemed inadequate by many Pakistanis, resulting in continuous low utilization of services. Barriers to access, such as socio-economic and cultural barriers, exist, which restrict the use of services by key population cohorts. With the mobility of women restricted in many regions of Pakistan, women, who often require urgent care, are unable to get access to health services even if the services are targeted towards them. Patriarchal, material and cultural factors are often a serious impediment to access for women.

Access to health care in Pakistan is estimated to be available for a little over half the population which is still better compared to other countries with similar levels of development. Although almost all of Pakistan's social development indicators are far worse than those of countries at similar levels of development, in the case of the health sector, Pakistan is marginally better off. Nevertheless, in an absolute sense, health access is quite limited and uneven by gender, class and region. Although 55 per cent of the population has access to some form of health service—with immense variability in quality and with varying ability to pay—the access to health services for maternal and child health facilities is further decreased to a mere thirty per cent. Added to this is the fact that while the government's immunization drive has been one of the major success stories of recent years, still only 57 per cent of children complete routine immunization and only forty per cent of pregnant mothers are fully vaccinated against tetanus. The demographic profile for Pakistani women is such that 43 per cent of the women are younger than 15 and nearly 46 per cent are in the reproductive ages of 15–49, implying that health services in the coming years will have to be focussed particularly on the young and on women, with reproductive health issues having to be brought to the fore. The existing health service structure is going to be severely challenged in the coming years with these demands and needs.

21.2.2 Examining Health Data

Unlike the literacy rate or the primary enrolment rates, which are indicative of the state of education in a country, there is no indicator in the health sector which captures the full picture of the poor (or otherwise) state of the health status of the population. Life expectancy at birth which, along with the literacy rate and the gross enrolment rate, is one of the four indicators which constitutes the UN's Human Development Index might, along with the Infant Mortality Rate (IMR), constitute some sort of poor proxy for an indicator about the health status of the population. However, while both might suggest some indications about the status of the well-being of a population, neither are indicators of ill-health or disease. Other indicators such as the Disability Adjusted Life Years (DALYs) lost or the Healthy Life Years of the population using the burden of disease index, do provide alternative partial measures of the status of health of a population, but are in turn, highly controversial indicators which are difficult to measure and calculate.[7]

A better indicator (or indicators), perhaps, is one which looks at the incidence and prevalence of diseases amongst a population, which shows the morbidity and mortality profile of the population. However, estimates and observations of such disease patterns are usually very poor and are constrained by the human and institutional capital of the country. In poorer countries, which have greater communicable and preventable diseases, the lack of adequate human skills and administrative and institutional structures to record, measure and calculate such disease patterns, makes analysis difficult. Moreover, to make such data available at a disaggregated level—urban/rural, province, district, and importantly by gender, or by age profile—makes assessment and observation even more precarious. Pakistan too, suffers from numerous of the data-related problems which affect other developing countries, and hence one needs a great deal of caution and imagination, in analysing data related to the health sector. Even where the data do exist, to hope to see many close correlations and sample sets where poverty and ill health data are captured simultaneously, is to be particularly optimistic. For example, while there are data on poverty, which show that there is a strong correlation between illiteracy or the level of education and the incidence of poverty, and while the relationship between ill-health and diseases is likely to be equally obvious, there is little data in the health sector which would corroborate such a fact.[8]

Disease Patterns

Table 21.2 reproduces data, which despite being almost three decades old and despite the demographic and social transition that has taken place, are still fairly indicative of the disease profile of Pakistanis. Probably the main difference would be that diseases related to the heart and circulatory system would have grown manifold, but because they represented such a small proportion, would still be relatively few in absolute number.[9]

Table 21.2: Main Causes of Death in Pakistan

(in percentages)

Nature of Disease	Total	Urban	Rural
Infective and parasitic diseases	53.84	67.64	63.07
Malaria	10.54	7.86	10.96
Congenital anomalies, birth injury, and perinatal mortality	8.49	7.03	8.79
Tuberculosis	5.55	2.86	6.09
Dysentery and diarrhoea	2.51	2.88	2.44
Accidents, poisoning, violence	1.88	1.05	3.03
Diseases of the heart and circulatory system	1.79	3.92	1.35

Source: Government of Pakistan, *Fifth Five Year Plan*, Islamabad, 1978, cited in Zaidi, S Akbar, *The Political Economy of Health Care in Pakistan* (Lahore: Vanguard, 1988), 55.

In more recent years, the burden-of-disease data have emerged as a proxy for ill-health and for the causes of illness and suggest that the distribution shown in Table 21.2, has not changed very significantly. In the World Bank's 1998 publication, *Pakistan: Toward a Health Sector Strategy*, data for 1990 which shows the burden of disease per cent of DALYs lost per year, shows that communicable diseases constitute 38.4 per cent of the DALYs, with maternal and perinatal conditions constituting a further 12.5 per cent, and non-communicable disease constituting 37.7 per cent—see Table 21.3.

Table 21.3: The Burden of Disease per cent of DALYs Lost per Year

Nature of Disease	Per cent
Communicable Diseases	38.4
Water Supply and Sanitation Pollution contributing to infectious and parasitic diseases, largely tuberculosis, diarrhoeal diseases, intestinal helminths and malaria	20
Air Pollution contributing Respiratory Infections	8
Childhood Cluster	6.7
Other	3
Non-Communicable Diseases	37.7
Cardiovascular	10
Nutritional Endocrine	6
Other	22
Maternal and Perinatal Conditions	12.5
Perinatal	10
Others	3
Others	11

Source: Centre for Research on Poverty Reduction and Income Distribution, *Pakistan Human Condition Report 2002* (Islamabad: CRPRID 2002), 26. [This Table was adapted from World Bank, *Pakistan: Toward a Health Sector Strategy*, World Bank, 1998]

Other burden of disease analyses for Pakistan show that communicable diseases constitute 49 per cent of the disease profile, while non-communicable diseases have risen to 41 per cent, with diarrhoea, respiratory tract infections, and maternal and perinatal diseases being the leading ailments in Pakistan.[10] The Healthy Life Years Lost analysis shows that the main causes of death in Pakistan are respiratory tract infections, diarrhoea, tuberculosis and birth-related diseases.[11] A 1990 survey using the burden of disease methods, 'showed that diarrhoea (40 per cent), lower respiratory tract infection in children (36.8 per cent), tuberculosis (35.7 per cent), injuries (31.9 per cent) and hypertension (29.9 per cent) were the six major factors of loss of healthy life years in Pakistan in 1990'.[12]

While some data are available for the population more generally, data related to the ill-health of children are often easier to find. Many micro studies measuring disease incidence are undertaken by researchers in the health and medical faculty. The IMR and the Under-Five Mortality Rate are calculated frequently and published. With a falling but still unacceptably high Infant Mortality Rate, many of the overall deaths in Pakistan take place in the under-five cohort. Of all the deaths reported in Pakistan, 'almost 39 per cent occurred amongst children under the age of five, and 30 per cent of them in children less than one year of age'.[13] Data collected from public sector health providers from across Pakistan show that 61.86 per cent of new cases of disease that were reported for children under the age of five, 'were the diseases that were either communicable or easily preventable. Acute respiratory infections (28.3 per cent), diarrhoea (14.7 per cent) clinical malaria (8.1 per cent), and dysentery (6.3 per cent) were the cause of the major complaints'.[14] Data for patients above the age of five follows a similar trend to that for children, although, not surprisingly, there was more variation in the disease pattern for older patients: the major communicable diseases accounted for 42.8 per cent of the cases reported, with acute respiratory infections accounting for 21.5 per cent, clinical malaria 7.7 per cent, and diarrhoea 6.4 per cent. Table 21.4 shows the distribution of disease for recent data.

Despite huge problems with data related to the health sector and particularly with regard to diseases, and despite the different sources and methodologies of collecting data, much of the disease pattern is more or less reproduced amongst studies in Pakistan. Table 21.5 below shows the ranking of the top ten causes of mortality and morbidity in Pakistan.

Table 21.4: Distribution of Deaths by Communicable Diseases, by Gender and Location (%)

Diseases	All areas		Urban		Rural	
	M	F	M	F	M	F
Typhoid Fever	5.35	7.97	3.68	6.12	6.44	9.15
Diarrhoea	2.79	5.59	2.76	5.76	2.82	5.49
TB	3.65	5.59	3.68	5.04	3.62	5.95
Pneumonia	5.83	5.87	5.83	6.12	5.84	5.72
Jaundice	5.1	5.17	5.52	5.04	4.83	5.26
All other diseases found in children	13.24	12.03	11.66	10.43	14.29	13.04

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 181.

Table 21.5: Leading Causes of Morbidity and Mortality in Pakistan

Rank	Premature Mortality	Morbidity
1	Diarrhoea	Hypertension
2	Lower Respiratory Tract Infection	Injuries
3	TB	Eye Disease
4	Rheumatic Heart Disease	Malnutrition
5	Chronic Liver Disease	Birth Diseases
6	Congenital Malformation	Congenital Malformation
7	Birth Diseases	Dental Disease
8	Ischemic Heart Disease	Ischemic Heart Disease
9	Child Septicaemia	Adult Female Anaemia
10	Other Respiratory	Mental Retardation

Source: Hyder, A. A. and R. H. Morrow, 'Applying Burden of Disease Methods in Developing Countries: A Case Study of Pakistan', *American Journal of Public Health*, 90 (8), 2000, cited in Centre for Research on Poverty Reduction and Income Distribution, *Pakistan Human Condition Report 2002* (Islamabad: CRPRID, 2002), 12.

The National Health Management Information System (NHMIS) data-base is based on utilization and disease reports from government health facilities in all the districts in Pakistan. Although the data-base excludes the huge private sector, the range of health facilities from where data about diseases are acquired, are probably adequately representative of the disease profile of the population. The most recent data that we have from the NHMIS is for 2003 and are shown in Table 21.6.

Table 21.6: Incidence of Major Health Problems Reported under the NHMIS 2003

Disease	Incidence
Diarrhoea Incidence/10,000	644
Dysentery/10,000	359
ARI/10,000	2152
Malaria/10,000	767
TB/10,000	78
Cholera/100,000	5
Meningitis/100,000	3
Polio/100,000	1
Measles/100,000	16
Neonatal Tetanus/100,000	1
Diphtheria/100,000	1
Viral Hepatitis/100,000	57
AIDS/100,000	0

Source: National Health Management Information System Data-base, provided to the author, by NHMIS, July 2005.

While there has been a health transition based on the demographic, fertility and the residential (urban/rural) changes that have taken place in Pakistan, the disease pattern has also changed, although communicable diseases still dominate the morbidity and mortality profile of Pakistanis, whether male or female, whether they live in urban or rural areas. Clearly, this pattern and structure of ill-health has important repercussions on the nature of interventions in and around the health sector, as well as on poverty. However, there are only a few studies which show the relationship between poverty and ill-health, and the degree of the relationship is left to conjecture and inference. Before we turn to such studies, we need to look at the regional distribution of key statistics, wherever data permits, within Pakistan. Table 21.7 provides provincial data for the IMR and incidence of diarrhoea on children.

Table 21.7: Regional Differences in Health-Related Data

	Infant Mortality (per 1,000 live births)	Incidence of Diarrhoea Children Under Five (%)
	Rural	
Punjab	101.7	13.9
Sindh	102.7	8.7
NWFP	58.7	15.6
Balochistan	75.1	9.9
AJK	48.0	8.4
Northern Areas	94.3	15.4
FATA	52.2	11.3
	Urban	
Punjab	70.6	10.5
Sindh	67.1	11.7
NWFP	62.0	11.7
Balochistan	120.6	10.7
AJK	63.2	12.8
Northern Areas	66.2	22.0

Source: World Bank, *Pakistan Poverty Assessment* (Islamabad: World Bank, 2002), 163.

The National Health Survey of Pakistan, published in 1998, although conducted between the period 1990–94, showed that there was a high prevalence of ill-health amongst women, where, in rural areas, 75 per cent of women over the age of 25 years, suffered from 'fair and/or poor health', while 45 per cent of the men in the same age group had the same health status.[15] Amongst low income women in the age group above 45 years, 'as many as about 45 per cent suffer from poor health and over 80 per cent suffer from poor to fair health'.[16] Another, more recent, survey conducted by the National Human Development Report and the Pakistan Institute of Development Economics (NHDR/PIDE) in 2001 addressed a range of questions related to some aspect of poverty as well as relating poverty to some health related issues. The NHDR/PIDE data showed that 'on average 65 per cent of the extremely poor were ill at the time of the survey and they had on average suffered from their current illness for ninety-five days'.[17] This National Human Development Report also quotes from data from the Pakistan Integrated Household Survey (PIHS), arguing that 'there is a strong correlation between income levels of household and immunization rates. For example, 75 per cent of the children in the upper income quintile were fully immunized as against only 25 per cent in the lowest income quintile'.[18] The NHDR/PIDE surveyed poor communities and found that as many as 55 per cent of the poor were ill at the time of the survey, and had been ill for 27 days on average, with their current illness.[19]

21.2.3 Utilization of Health Facilities

The National Health Survey found that the average number of contacts with a health care provider over the age of five years was 5.4 visits a year. This includes providers of all types and categories, viz. government doctors, private doctors, dispensers, paramedics, *hakims*, homeopaths, faith healers, even medical stores and a 'few non-specified providers'.[20] Males in rural areas visit health/medical care providers on average 4.7 times a year, compared to urban men who visit 5.4 times a year. There is absolutely no doubt that there is a great deal of gender bias and discrimination against women in all walks of life and amongst all categories of social class in Pakistan. However, one of the more persistent beliefs in academia and amongst researchers in Pakistan in the social sciences regarding access to health/medical facilities by women, is proven to be wrong by evidence. Data shows that *females tend to use the services of health care providers more than men*, with their average of 5.8 visits being higher than the 4.9 visits by men.[21] While it is not surprising why this happens, this is a rather important statistic in understanding issues about ill-health and well-being with regard to women in Pakistan.[22] (It is also important to state, that the frequency of visits has little to do with the quality of care received by either men or women—see also below).

In terms of visits and economic and social category, the National Health Survey found that there was not a very significant difference in the average number of visits and economic status. It found, that 'in urban areas the average number of annual visits to health care providers made by males and females of middle income status is only slightly higher than those who have higher or lower status. However, in rural areas, females and males of low economic status make fewer visits to health care providers' than do those of higher status.[23] The Survey makes an important clarificatory point regarding this evidence when it argues, that

> those of low economic status are more likely to describe themselves as having poor health on many measures they have greater objective need. The lack of a relationship between economic status and mean number of annual visits to health care providers might be interpreted as evidence for unmet needs for health care.[24]

One of the most important, and in many ways, surprising, statistic concerns the distribution of the utilization of health facilities between private and public (government). Amongst the numerous categories of health/medical care providers mentioned above, the use of and access to private doctors constitute the largest proportion amongst all categories of age, gender and location. The National Health Survey of 1990–94 shows that thirty-five per cent of the visits of rural females to health care providers are to private doctors;[25] in all categories—urban/rural, male/female—private doctors provide between 45 and 65 per cent of all care. Amongst rural men over the age of 65, private doctor visits constitute 46 per cent of all visits, while for urban men, the proportion is 65 per cent. Across the entire population, government doctors provide only 21 per cent of all health/medical care. Other findings from the Survey show that: rural inhabitants rely more on dispensers and paramedics than do urban dwellers; women rely more on dispensers and paramedics than men do; and, despite a belief amongst many researchers, the findings from the Survey reveal that traditional health care providers, such as *hakims*, homeopaths, faith healers, and medical stores, 'provide a very small proportion of care'—only three per cent of visits were made in this category.[26]

The National Health Survey reveals that economic status is clearly related with the type of provider chosen for health care, with a variation in rural and urban areas, although many of the findings detract from conventional wisdom. In rural areas, people belonging to the low economic status category, surprisingly, turn to government doctors *less frequently* than do members of the 'middle' or 'high' economic category, and men in the 'low' category in the rural areas visit private doctors far more frequently than do men in the high and medium economic groups, although in all three categories private doctors dominate. Amongst women in the rural areas, those from the low category visit government doctors less frequently—as a proportion of all facilities visited—than do women in the middle and higher categories; for low economic status women in rural areas, the main providers are dispensers/paramedics: 43 per cent of all visits. Of all the twelve categories—high/middle/low, urban/rural, male/female—in only the low economic category of rural women, do private doctors not dominate as main line of care providers. Clearly, *private doctors are the main health/medical care providers of all men and women, rural and urban, across almost every single economic category*.[27] Another important finding is that even among the low economic status group, visits to traditional health care providers—such as *hakims*, homeopaths, faith healers and medical stores—is very infrequent. More interestingly, it is not women who frequent 'traditional' health providers as is commonly believed, but the highest level of utilization of such providers is amongst the low economic status urban men.

A 2002 World Bank study found that in the case of female health care data related to utilization, there was a strong correlation with income. For example, in the lowest expenditure quintile, only 11.9 per cent of rural women had a pre-natal consultation, while in urban areas the proportion for the same category was 36.4 per cent; in the case of the highest quintile, the figures were 31.9 per cent and 84.2 per cent, respectively.[28] Similar trends were found with regard to deliveries at home and deliveries assisted by trained personnel where, as income increased, fewer deliveries occurred at home and a greater proportion of better-off women had trained personnel present at the time of delivery. Moreover, knowledge and use of contraception also increased with income, and the number of children fell as income increased.

Many of the findings from the National Health Survey regarding utilization and social and economic class, are supported by the evidence from the NHDR/PIDE survey. The Survey shows that rather than going to homeopaths, hakims or even government hospitals and dispensaries, the poor 'predominantly go to private allopathic medical practitioners. This is reflective of the desire of the poor to get the best

Table 21.8: Type of Health Facility used by Economic Category

Economic Status	Allopathic Private Medical Care	Govt. Hospital	Govt. Dispensary	Compounder or Chemist	Community Health Worker	Homeopath, Hakim, Other
Extremely Poor	57.8	12.0	7.2	13.3	1.2	8.4
Poor	45.9	16.3	8.2	22.4	0.9	6.1
Non-Poor	64.4	8/9	8.9	15.6	–	2.2
Average	54.0	13.3	8.0	17.7	0.4	5.6

Source: Hussain, Akmal, *Pakistan: National Human Development Report 2003* (Karachi: Oxford University Press, 2003), 70.

medical treatment for their loved ones'.[29] Table 21.8 shows the utilization of health facilities by the poor, and shows that even the 'extremely poor' prefer private health/medical care providers over all others by a very significant proportion. Perhaps what is more surprising is that 49.4 per cent of the extremely poor have to travel a distance of over six kilometres to seek health/medical care, as compared to 29.5 per cent of the poor category. Despite this severe constraint, in terms of time lost and money spent by those who as it is have very little, the extremely poor group spends far more on private medical care than do the poor—see also Health Spending, below.

21.2.4 Health Spending and Health Expenditure

As a share of its GDP, total health expenditure for Pakistan is about 3.9 per cent, of which the government's share has not exceeded 0.86 per cent of GDP. Public expenditure in the health sector in Pakistan has been around 0.7–0.8 per cent of the GDP in the last 35 years, or around a mere 3.5 per cent of total government expenditure. In fact, the *Pakistan Economic Survey 2004–05*, shows that for 1995/96 and 1996/97, the government's share of expenditure on the health sector was 0.8 per cent of GDP, which fell to 0.7 over the period 1997–2002. However, this trend was further aggravated after 2002/03, where expenditure on health in the public sector *fell to a mere 0.6 per cent* over the three years from 2002/03 to 2004/05. It is not just the fall in absolute allocations in the public sector to the health budget which is worrisome, but within the budget allocations to the health sector, the fact that as much as 60 per cent goes towards salaries, while the 'remaining 40 per cent is consumed in financing maintenance work, procurements, up-gradations, and medicines, etc. Expenditure on medicines, in the budget of primary health facilities, forms only 24 per cent of the budget'.[30] Clearly, this is a most alarming trend which is bound to have serious consequences on the health outcomes of the population. In line with this trend of falling government expenditure on health, has been the rise in the proportion of private health spending in recent years. However, over the period 1997–2001, while the overall *proportion* of private health spending—which is almost exclusively out-of-pocket spending—as a share of total spending has risen, there has been a *marked fall* in per capita overall spending on health care in Pakistan—see Table 21.9.

Table 21.9: Health Expenditure in Pakistan: 1997, 2001

	1997	2001
Total health expenditure as % GDP	3.8	3.9
General govt exped on health as % total exped on health	27.2	24.4
Private exped on health as % total exped on health	72.8	75.6
Per capita expenditure on health (public + private) US$	19	16
Private per capita expenditure on health US$	13.83	12.1

Source: World Health Organization, *The World Health Report 2003: Shaping the Future* (Geneva: WHO, 2003).

While these more general trends are quite alarming, perhaps one of the most significant indicators related to the health sector is that private spending is as much as 76 per cent of total spending, a factor that has some important policy implications.[31] In terms of household spending on health, data is difficult to come by. The NHDR/PIDE survey found that in its category of 'extremely poor', they spent Rs. 1,885 on health related expenses, while those who were designated as 'poor', spent Rs. 497, in both cases on their current illnesses.[32] The extremely poor were in their current illness for 95 days and the poor for 56 days on average. Hence, the extremely poor were ill for much longer and were probably unable to work while ill, but also spent almost four times as much as the poor in total; moreover, on a per day basis, the extremely poor spent around Rs. 20 per day while ill on their treatment, while the poor spent less than half, around Rs. 8.88. Added to this, is the fact that almost half of the extremely poor had to travel more than six kilometres seeking health/medical care while 30 per cent of the poor had to travel a similar distance.

Data available from 1985/86 to 2001/02 reveals that the proportion of expenditure spent on health by households, as a proportion of their total expenditure, has almost doubled in this period—see Table 21.10. What is interesting from the table is, that rural households have always spent more on health related expenditure as a proportion of their total expenditure, than urban households. Moreover, the proportionate expenditure on health has remained almost the same in urban areas throughout the period 1985/86 to 1996/97, while the rural household's share has risen in this period. In both cases, however, there is a large rise in the proportion in the years between 1996/97 and 1998/99.

Table 21.10: Percentage Household Health Expenditure as a Proportion of Total Expenditure

Year	Urban	Rural
1985–86	2.3	2.5
1986–87	2.4	2.6
1990–91	2.6	3.1
1992–93	2.4	3.1
1993–94	2.5	3.1
1995–96	2.3	3.1
1996–97	2.4	3.1
1998–99	3.6	4.7
2001–02	4.7	4.7

Source: Government of Pakistan, *Social Indicators of Pakistan 2003* (Islamabad: Ministry of Health, GOP, 2004), 89.

The rise in health expenditure can be attributed to a number of factors. There has been an increase in health facilities, both private and public, across Pakistan, and it could be that now since people have better access and availability of health personnel and health facilities, they can now make use of these facilities, having to spend more on health than on other expenditure heads. It is improbable that this increase is on account of a growth in income, since in the 1990s, there was a rise in poverty and a slowdown in economic growth, with the rate of increase in the growth of per capita income slowing down. Perhaps greater awareness about health and medical measures has led to an increase in spending on medical care. Since the consumer price index for medicines has been exactly the same as the general consumer price index, this proportionate increase is not due to a relative price effect. Whatever the reason, *it is clear that households are now spending more money on health as a proportion of their total expenditure than in the past.*

21.3 Health Outcomes and Non-Medical Interventions

In the section above, we have looked largely at health/medical related data and interventions which have an impact on health outcomes and on the health status of the population. However, as we mention above, health outcomes are affected by, not just direct medical and health interventions, but by a host of factors which have an indirect relationship to health outcomes. Interventions in the education sector, in housing, access to water, etc. all have a significant influence—and in some cases, even stronger influence than health interventions—on the health status of the population. *Health,* more than any other sector amongst the social services, *requires a holistic approach in order to understand the problems and constraints faced by that sector,* and to find effective solutions. In this brief section, we highlight some of these non-medical interventions and wherever data permit, relate them to income and poverty related data.

One of the most important non-medical inputs towards better health, is women's (or more specifically, maternal) literacy and education. Women's health and that of her children and the rest of the household, improves at each stage of increase in literacy and education. Contraception use increases with education and the fertility rate also falls as education rises. As a consequence of these factors, health data also show a correlation between mother's level of education and infant mortality and there is evidence, 'that infants born to the least educated mothers have twice the risk of dying within the first year after birth compared to those born to more educated women'.[33] Regarding the malnutrition of children in the household, one finds similar sorts of relationships, where there is a '60 per cent more chance of finding malnutritioned [sic.] children in households where the mother is illiterate compared to households where the mother has at least had high school education'.[34] Clearly, *mother's education and literacy is a very important health intervention.*

While illiteracy and ill-health have a high correlation, so do poverty and illiteracy, and hence, the poverty-ill-health nexus is further accentuated and reinforced through illiteracy. While the overall literacy rate in Pakistan is quite low, that for the poor compared to the non-poor is even worse. The overall literacy rate amongst the poor for both men and women, was found to be 28 per cent, almost half the 49 per cent for the non-poor. This figure is worse for poor rural women, who have a literacy rate of only 9 per cent compared to the equally poor 21 per cent for non-poor rural women. These results have 'wide-ranging adverse implications, given the importance of a mother's education for the educational attainment and health of children'.[35] This pattern is, not surprisingly, replicated in the net primary enrolment rates, and like literacy, holds across the provinces and rural and urban areas. Enrolment is particularly poor among female children in rural areas at 25 per cent, compared to 45 per cent for the non-poor rural female children.[36] While these statistics reveal specific education and skill related problems with regard to poverty, where the poor are stuck in a poverty-trap unable to acquire basic educational levels in order to move out of poverty, the literacy/education-health-poverty cycle is further accentuated and reinforced, leading to an iterative poverty trap.

Many of the communicable and preventable diseases mentioned in the foregoing section are water-borne diseases—diarrhoea and dysentery, in particular—and can be eliminated if better quality and increased quantity of water is supplied. With better sanitation, other air-borne diseases can also be reduced. Moreover, treatment for diarrhoea in the form of oral rehydration salts, only helps to momentarily and partially mitigate the illness, and when children return to their habitat, they are once again exposed to the same vectors which made them ill in the first place. If cleaner water and better sanitation facilities were provided, the causes of the illness would be either removed or reduced. All of those who are exposed to inadequate quality and quantity of water and poor sanitation conditions are exposed to disease and ill-health. Not surprisingly, the lack of both water and sanitation affect the poor more than the non-poor, making the poor even more vulnerable to disease.

The poor have less access to safe water, sanitation and drainage facilities compared to the rest of the population: 'as

much as 24 per cent of the poor rely on potentially unsafe sources for drinking water, compared to 19 per cent of the non-poor'.[37] Table 21.11 shows the access to water and sanitation facilities amongst the poor and non-poor.

Other factors that affect communicable disease such as tuberculosis, for example, which is communicated through air-borne vectors, include: unhygienic living conditions, overcrowding and malnutrition, which lowers resistance to the disease. Non-medical interventions can go a long way in reducing the incidence of this disease.

21.4 The Poor and the Socio-economic Impact of Communicable Diseases

The lack of adequate and reliable data limits any calculations with any degree of certainty regarding the social and in particular, economic, costs at either the individual, household or country level related to communicable and preventable diseases. While broad. 'ball-park' figures do exist regarding the incidence and prevalence of disease, data from different sources often contradict that from other sources. Moreover, the lack of socio-cultural studies which examine the cultural and social aspects and consequences of certain diseases, also limit an evaluation of the non-economic impact of these diseases on those who suffer their consequences. Nevertheless, making some assumptions, we can try and make some general statements about the socio-economic consequences of some diseases, trying to examine implications for socio-cultural and religious stigma and human rights, particularly for vulnerable groups amongst the poor. From the disease profile shown in Section 21.2 above, the most widespread diseases which affect the population of Pakistan, and in particular the poor, are communicable and preventable diseases, such as diarrhoea/dysentery, respiratory tract infections, malaria and tuberculosis; although it has a low incidence and low prevalence rate, but because of the high social, economic and human costs associated with it, HIV/AIDS also features in a list of critical diseases in the context of Pakistan.

Given the high cost of care—see the next section—and the proportion of income to be spent on care, much of which goes towards private medical care even amongst the very poor, and depending on the severity of the illness and the ability to pay for the care, one can assume that the implications of acquiring medical care will be significant for the household which has an ill family member. If the poor, by definition, do not have enough funds to pay for health/medical care, they will have to first make the choice whether they are in a position to seek care. The data that we have about the choice of health/medical care provider relates to those who *actually seek care;* we do not have adequate data about those who are even *unable to be in a position* where they can opt for one of many medical care providers. The percentage of the poor who are forced to live and work with a disease and do not access any sort of health/medical care, is unknown.

A decision to acquire medical care, particularly amongst the poor, depends on a number of factors. This will depend, perhaps in the first instance, on whether a health/medical care provider/facility is available and accessible. The need to seek medical care will depend on who is ill—it is very possible that the household or its head may, due to a shortage of funds, decide not to seek medical care for certain (perhaps very aged) members of the household; evidence does suggest that women and girls are often lower in priority in developing countries compared to boys, when it comes to taking the patient to a medical facility; in the priority ranking, it is very probable that the main income earner will have a higher ranking than anyone else in poor households where not every member of the household has the luxury of accessing health care and where choices have to be made. The cost of not acquiring care by the main earner is likely to be higher than those of acquiring care. The severity of the disease is likely to be another factor which affects the decision to seek health care. Given the considerable expenses and costs incurred—both direct and indirect—in having to acquire medical/health care for the poor, it is very probable that a decision to seek care will be delayed, aggravating the disease. Moreover, for the reasons mentioned above, even diagnosis of the disease will be delayed and many amongst the poor may continue to live with a disease without even knowing that they have contracted it. Delayed diagnosis at an advanced stage will only aggravate the disease and incur higher costs.

Once a decision has been made to acquire health care, economic implications arise since the care has to be paid for, as does the cost of transportation, medicines and perhaps even hospitalization. If the poor do not have the income to pay, they will have to either borrow or sell some of their already negligible assets in order to be in a position to pay for the care. Either of these two decisions are likely to make their economic position worse. In fact, often a minor illness can push a household which is above the threshold of poverty, into a state of poverty exacerbating the poverty-ill-health relationship.

Table 21.11: Access to Drinking Water and Sanitation for the Poor and Non-Poor

	Source of Drinking Water			Drainage System			Toilet	
	Piped	Outside Closed	Open Source	Under-ground	Open Drain	No Drain	In House	Outside House
Poor	18.7	57.3	24.0	7.8	29.8	52.4	40.9	59.1
Non-Poor	28.2	53.1	18.6	17.2	34.3	48.5	61.0	39.0

Source: World Bank, *Pakistan Poverty Assessment* (Islamabad: World Bank, 2002), 36.

One can perhaps make the claim, that issues related to social relations, social capital and social networks, that exist for poverty mitigation and help deal with poverty amongst communities amongst the poor, are extended when it comes to most, particularly non-contagious, illnesses.[38] Perhaps it would not be wrong to suggest that the same or similar, community-based and social networks work with regard to dealing with poverty and illness amongst the poor. This is particularly likely with regard to maternal and child related illnesses, where a broad nexus of women of all ages in the community may share support. With varying social ties amongst communities, support might be forthcoming from other members of the broadly defined community. Despite major changes in the social and cultural process in Pakistan, it would be fair to suggest that, for the most part, communities still have strong social ties and networks. However, where communities suffer equally—a likely assumption in the case of poor communities facing many similar diseases—it might be difficult to find support when everyone is dealing with illness in their own household. This might also be the case where the main earners of the household migrate and work away from home in alien environments. However, research related to, for example, migrant workers, has shown that original kinship patterns from rural areas still exist in cities and are often reinforced and reproduced there. Such patterns perhaps transfer social networks and social capital from one location to another. Such social networks are probably quite strong in Pakistan where they provide support of many kinds, including loans and credit: relatives and friends are the main source of finances for all social groups and the persistence and working of Rotating Savings and Credit Association (ROSCAS), bear testimony to a strong system of social relations, social networks and social capital.

While 'normal', less contagious, diseases might not account for any degree of the social exclusion of individuals and households amongst the poor, partly because dealing with disease and living with various stages and degrees of ill-health is very much a part of the existence of the poor, it is very possible that in the case of some diseases individuals and households are ostracized. Amongst the more common diseases, probably tuberculosis could be such a disease, as well as HIV/AIDS of which there is growing awareness due to extensive media campaigns. However, in order to be ostracized, the nature of the disease has to be identified first. This means that diagnosis has to take place before a disease is identified. As we argue above, this may not be the case with regard to the poor who may not have their illness identified, and may continue working and living with the disease, despite the health hazard to the person themselves and to the wider community at large. Although less than 100,000 cases of HIV/AIDS have been estimated in Pakistan, one can be quite sure that patients with this condition, once diagnosed and identified, are likely to be ostracized from their larger communities and will also face religious and social stigma. (However, since HIV/AIDS is more widespread amongst certain groups—injectable drug users who share needles, in particular—an alternate argument also exists which would suggest that many of the sufferers of HIV/AIDS *are already excluded*, socially, culturally and economically, on account of non-disease related factors, and that it is not this particular condition which is responsible for their exclusion).

This section maintains that the social networks and socio-cultural patterns of relationships amongst the poor are fairly strong at the *biradari* and community level, and are carried in to issues which relate to ill-health and well being. Extended families and 'traditional' relationships of larger communities still exist in Pakistan and provide social support amongst members. Moreover, the concept of charity and community support in Islam would also endorse such a view. In fact, one can argue that social exclusion which is based on illness and disease is not a matter of much concern, for the poor are already fairly excluded from access to health and non-health opportunities and facilities. What is of far greater significance is the social exclusion of the poor and of women and religious minorities, more generally, rather than the social exclusion faced by those who are ill. Having said this, however, one must also add that while numerous smaller groups of support might exist in multiple conditions and environments, social exclusion of the physically and mentally disabled, for example, is fairly commonplace in Pakistan. When disability or disease is more visible and detectable (physical disability, for example), it is possible that ostracism will take place.[39] On the other hand, the 3 million tuberculosis sufferers in Pakistan, for example, probably do not suffer from exclusion because their diseases go undetected except in acute cases, and many have little choice but to continue with their lives living and working with a disease of which they may not even be aware of—and even if they are aware of the disease, their poverty would force them to continue living and working with their ailment.

The Mahbub ul Haq Human Development Centre Report, *Human Development in South Asia 2004: The Health Challenge*, perhaps best summarizes issues raised about exclusion and access as follows:

> For almost all the indicators we have covered so far there are clear differences in health outcomes based on gender, geographic location, and income. So, it is not only the case that our achievements in [the] health sector are poor it is also the case that biases based on gender, location and income raise serious equity, fairness and access issues.[40]

Clearly, the issue of exclusion and of access is not related primarily to disease and ill-health, but prior factors such as gender, geographic location and social class, in a highly segmented and social- and class-conscious Pakistan, only emphasize the exclusion faced on account of disease and illness.

21.5 The Issues of Price, Cost, and Access to Treatment

Data for the cost of health and medical care in Pakistan is imprecise and extremely scarce. If government price indices are to be believed, over the period 1990/1 to 2010/11, the price of medicare rose at a slower pace than the increase in the general price index, the price rise in food and beverages and

tobacco, apparel textile and footwear, house rent, fuel and lighting, transport and communication, household furniture and education. In the eleven groups which constitute the combined consumer price index, it is only 'recreation and entertainment' which rose at a slower pace than medicare. The rise in the medicare price index over these twenty years has been by a factor of 4 compared to more than 5.2 times for the general consumer price index. Moreover, government data show that the 'doctor clinic fee' over the same period, has risen by only 3 times.[41] Looking at data for the daily wages of skilled and unskilled workers in Pakistan's main cities, one sees that the rise in wages between 1992–2004 was also in the range of 2.4–2.7 times the 1992 wage, showing that there had been some deterioration in relative well-being due to prices rising faster than incomes.[42] In the period 1999–2011, the unskilled workers daily wage had increased about three-fold. However, anecdotal and other survey data suggest that health and medical care have become far costlier for consumers and because of the high, double-digit, inflation since 2008, are now unaffordable for most people, particularly the poor.

Since we do not know what proportion of the ill, and particularly of the poor, are unable to utilize health facilities on account of the unaffordable actual and hidden costs involved in purchasing and accessing health/medical care, attempts at trying to estimate the extent of access to health/medical care by the poor, must remain partial and speculative. All our estimates are based on the actual usage of medical/health facilities by different segments of the population. From the NHDR/PIDE survey cited above, we know that the 'extremely poor' are ill for twice as long as the 'poor' and despite being poorer, spend around 3.8 times as much as the poor on medical/health care.

Unfortunately, there have been far too few studies which look at the cost of treatment of the main communicable diseases in Pakistan. One study conducted by Logan Brenzel and S. Akbar Zaidi in 1996 as a background chapter to the World Bank's Health Sector Strategy calculated the costs of curative care by the government at different tiers of public health facility.[43] Another study examined the economic and social costs of tuberculosis and its treatment in Pakistan.[44]

The Brenzel and Zaidi study calculated the cost of curative care for a number of illnesses which have a significant impact on the health status of the population. From the survey conducted for this study and from the data collected, estimates were made of unit costs per curative outpatient case, i.e. averages for all conditions; similarly, unit costs per inpatient admission were also calculated. The study calculated the actual unit costs for care as delivered in government health facilities, and estimates 'were also made of what those unit costs would be if a full course of treatment in accordance with generally accepted professional standards was approved at government expense', and are referred to in the Report as 'normative' costs as opposed to actual costs incurred.[45]

Table 21.12 shows the estimated actual costs incurred for curative outpatient services at different levels of government health facility. In the 'fixed costs' category, which consumes the most amount of costs, labour accounts for 72 per cent of fixed costs, followed by administration at 15 per cent and buildings at 9 per cent; variable costs include the cost of medicines, laboratory tests and x-rays. Only those medicines supplied or tests conducted at the facility are included in these estimates. Normative variable costs are estimated on the basis of costs for medicines required to treat a typical case of a particular disease or condition, and based on the weighted incidence of disease found at each level of facility.

One of the main findings based on Table 21.12 is that at all four tiers of government health facilities, the actual expenditure per outpatient for variable inputs provided by the government—largely medicines—falls far short of what it would be needed for a full course of treatment. If we assume that a patient using a government health facility is interested in having his/her ailment cured and fully treated, s/he will have to purchase the medicines in the market and will have to incur considerable personal out-of-pocket expenses even when health/medical consultations are 'free'. Even when some form of diagnosis and consultation takes place without any actual costs incurred—or marginal direct costs such as user fees or *parchi* fees—patients bear the full treatment costs for the disease.

21.5.1 How Much Does it Cost to Cure Tuberculosis?[46]

The World Health Organization had identified sixteen key countries, where a lack of progress in combating tuberculosis is threatening global TB control efforts. These sixteen countries, which form the 'world's most worrisome TB trouble spots' were those countries which had not moved quickly to adapt the DOTS strategy, and some of these governments had not taken WHO's Global TB Emergency of

Table 21.12: Estimated Unit Costs of Outpatient Health Care (in 1995–96 Rupees)

	BHUs	RHCs	THQs	DHQs
Fixed Costs/Visit	43.0	54.0	35.0	25.0
Actual Variable Costs/Visit				
– Medicines	5.9	13.6	15.3	12.5
– Other Variable Costs	0	0.6	2.0	2.5
Total Actual Costs/Visit	48.9	68.2	52.3	40.0
Normative Medicine Costs/Visit	58.0	58.0	146.0	146.0
Normative Medicine Costs/Actual Medicine Costs	9.8	4.3	9.5	11.68

Source: World Bank, *Pakistan: Health Sector Strategy*, Report No 16695-PAK (Washington DC: World Bank, 1998), 24.

1993, seriously. Of these sixteen 'worrisome trouble spots', eight countries were classified as middle and/or upper income countries and did have the financial means to address the aggravating TB situation[47], while eight others belonged to the low income group. Pakistan happened to be one of the latter group of eight[48].

While these sixteen countries have been singled out as a group for their poor record to address the growing TB emergency, WHO identified ten of these sixteen, which had started using DOTS more recently, and hence there was a belief that many of these trouble spots may soon become TB-control or TB-free, success stories, where TB could be effectively controlled, if not eliminated. Hence, there were six countries of the world, where TB was rampant and yet little or no response by the government had been made to address this potential epidemic. Pakistan had the unfortunate distinction of being one of those six countries where tuberculosis was a problem, but official response to address this issue has been largely insufficient[49].

These very basic stylized facts, which rank Pakistan as one of the six worst performers in its efforts to tackle the TB crisis, need to be contrasted with the performance of numerous poorer countries which have begun to give TB eradication high priority. Of the WHO's list of sixteen worst performers in 2004, Afghanistan, Myanmar and Sudan were all far poorer than Pakistan, and yet, had implemented DOTS and had started giving due emphasis to this problem. Other countries, such as Bangladesh, Mongolia, Cambodia and Kenya, all considerably poorer than Pakistan, were already on the road to achieving some success in controlling tuberculosis. Even Malawi, the fifth poorest country in terms of GDP per capita, with a per capita only one-third of Pakistan's, had been cited by WHO as a country where TB control was succeeding.

Around three million Pakistanis suffer from tuberculosis and approximately 250–300,000 new cases are added on every year; about 50,000 patients with tuberculosis die each year. Tuberculosis as a single disease accounts for 5 per cent of the total burden of disease in Pakistan, and its importance can only be emphasized by the fact that tuberculosis 'kills more women every year than *all the cases of maternal mortality combined*'.[50] Although the DOTS strategy was started in 1995, the coverage of DOTS at 45 per cent is the lowest in South Asia, and the DOTS detection rate in Pakistan at only 13 per cent, was also the lowest in the region by a considerable margin. Pakistan also had the lowest treatment success rate in South Asia.[51]

In a study conducted in 2000, it was found that the costs for medication during the course of a nine month regimen for a patient with tuberculosis in Pakistan, work out to approximately Rs. 13 per day, or Rs. 400 per month.[52] A nine month medication course would have cost around Rs. 3,600 (US$80) following the WHO-approved DOTS regimen. Five sputum microscopy tests, plus doctors fees, each at the rate of Rs. 10 and say, Rs. 50 respectively, would have added another Rs. 300 if we assume that the patient makes five visits each to the doctor and to the laboratory. Hence, we have a total medication package of say, Rs. 4,000 or less than US$90 over a nine month period to cure one patient with tuberculosis in Pakistan.[53]

This cost calculated here is a crude, bare minimum, cost that would be required to provide medication to cure each TB infected person. It does not include a host of numerous direct, indirect or opportunity costs related to the treatment. For example, costs related to the supply and training of health service providers, the transportation of medicines, and the provision of laboratories. If we assume that the DOTS method is to be applied, we need to factor in the cost of community or field workers. There are costs which the patient must bear on his own, which include transportation, costs related to better food intake and better nutrition—an essential ingredient in recovery from tuberculosis—and the costs borne if he is out of work in the earlier phases when he is under treatment. All these costs together can be very substantial.

The Brenzel and Zaidi study calculated that if an out-patient was treated for tuberculosis at a Rural Health Centre, he would incur medication costs of between Rs. 43–Rs. 1,213. At a Taluka/Tehsil Headquarter Hospital, drugs worth Rs. 511 would be prescribed to TB patients, and at a District Headquarter Hospital, the out-patient drug costs per case would be Rs. 80.[54] These costs, based upon health centre records, were actual treatment costs for tuberculosis treated in the out-patient department at each tier of the health delivery system. In the case of tuberculosis, our results showed that it is far more cost effective to treat an out-patient by administering him tests and drugs at a higher District Headquarter Hospital level, rather than at the first contact of health service, such as a Rural Health Centre or Basic Health Unit. The reason for this is probably due to economies of scale at the higher tier. Also, because of higher utilization rates for hospitals, the study found that it was more cost-effective to provide outpatient services at higher levels of the health system—the unit cost decreased at higher levels within the system.

The normative costs that this study assumed for an out-patient treatment of tuberculosis, based upon medication and diagnostics at a government health facility (which is free) was Rs. 3,195. Of this Rs. 2,110 was the cost of medication for a tuberculosis case, while Rs. 1,085 were for diagnostics, which included microscopy and X-rays. The in-patient treatment costs for tuberculosis were Rs. 3,871 at a Rural Health Centre, Rs. 4,236 at a Taluka Headquarter Hospital and Rs. 4,552 at a District Headquarter Hospital. These in-patient costs included all costs related to service and care while the patient was in hospital[55]. The average length of stay per in-patient for tuberculosis observed was 10.33 days at a Rural Health Centre, 9.39 days at a Taluka Headquarter Hospital and 6.12 days at a District Headquarter Hospital.

Estimates from the Bethania Hospital in Sialkot, a non-profit charitable hospital dealing with tuberculosis, have calculated the total cost (including hospitalization) for a TB patient to be Rs. 5,863 ($130). This figure includes six sputum examinations, each at Rs. 18, sixty days hospitalization at Rs. 50 a day, one X-ray cost, thirteen OPD visits to the doctor at Rs. 40 per visit, and medication worth Rs. 2,135 to cover the entire course of the treatment.

While the cost of treatment of tuberculosis per case in Pakistan, seem to lie in the range of US$100–130, depending upon how and where treatment is undertaken, the costs for government administered care for TB seem to be higher

because these figures are more comprehensive as they include fixed costs, doctor's salaries, etc. The private sector treatment costs above, are for treatment cost only (medicine, diagnosis and consultant's fee, i.e. excluding hospitalization) costs. How do these costs compare with treatment costs in other countries?

A comprehensive study on India[56] has calculated that the cost of treatment for a TB patient was US$0.40 per day, and a consultant's fee ranges from US$0.50 to $7. Treatment in the private sector for out-patient out of pocket costs would be in the range US$110–140, if treatment was actually undertaken. These costs do not include opportunity costs or nutritional costs. The study also calculated costs prior to treatment: in the private sector the cost of diagnosis ranges from $3–7 which is the cost of an X-ray and three sputum microscopy tests. In addition, there is the cost of treatment prior to diagnosis, which the study calculated to be around $10–13. The average cost to the patient for diagnosis and the treatment preceding diagnosis was about $17 per case.

Other studies have also tried to calculate the cost of treatment of tuberculosis, but are strictly not comparable since each study on each country is unique for what it includes in its calculations of cost and for what it excludes. The study by Katherine Floyd and her colleagues compared the costs incurred for a DOTS regimen with that of a conventional programme in rural South Africa[57]. While the costs on a DOTS programme were about one-third that of a conventionally delivered treatment programme, the DOTS package comes to about $741. The high cost in this is the cost of hospital stay ($557) which is around 75 per cent of total costs for the treatment—a day in hospital costs $27.80 for the health system and $4 to the patient; in Malawi, a day in the hospital, in comparison, incurred only $2.09 in health system costs. The cost of drugs even for the conventional treatment is only $40, far less than those incurred in Pakistan. Sputum costs were also comparable at $9. Saunderson's study on rural Uganda, which included pre-diagnosis costs (as did the India study cited above) calculated that the costs to the health system would be around $90 per case, and to the patient nearly $215. An alternative treatment design package reduced patient costs substantially to only $80 which included pre-diagnosis costs. These costs also include the cost due to a loss of work, which many studies do not[58].

Differences in methodology and data constraints limit any comparison between studies and countries and, at best, are merely indicative. Moreover, cost-effectiveness studies and costs foregone either by the health system as a whole, the government, or the patient, tell us nothing about the actual quality of care being provided.

This case study of the cost of care for tuberculosis needs to be seen as representative of the broader problems related to issues of costs and prices of care, and hence of access. We learn a number of things from our analysis of tuberculosis which are indicative of more generic problems. Tuberculosis is one of Pakistan's main diseases and causes a large number of deaths as well. However, it is a fairly simple disease in terms of treatment, largely requiring consistent treatment in the form of medication, over a period of around nine months. However, the fact that as many as 15–20 per cent of those who contract tuberculosis each year will die from the disease, is of serious concern. Moreover, tuberculosis is also a contagious disease and hence, preventable.

The reason why tuberculosis persists and spreads and accounts for many deaths, may all lie in issues related to poverty. The poor probably have a high incidence of tuberculosis and it is they who need treatment most but do not have the minimum US$100 for treatment. While a patient is unable to acquire treatment on account of costs, s/he lives with the disease probably passing it on to others as well. Since tuberculosis is a debilitating disease, productivity of active workers will also fall as the energy levels of those who suffer from it, falls. Moreover, tuberculosis has a higher incidence in the economically productive age group 15–29 (42 per cent of all cases are in this age bracket) and if the main earner in a household is affected, one can assume that his/her earning capacity will be also affected on account of the disease and the entire household dependent on this earner, will suffer. A poor household afflicted by tuberculosis is likely to get stuck in a condition of perpetual poverty, despite the fact that the cost of care is still relatively inexpensive. The answer to the question of access to treatment in an environment where around 32 per cent of the population is poor and where the poverty line was less than Rs. 750 per month per adult equivalence in 2000/01,[59] is self-evident: it is not at all possible for anyone with income of this amount to spend around Rs. 500 on the treatment of tuberculosis, and even if their condition has been diagnosed, they do not really have 'access' to health care. Clearly, the poor will continue to live and die with diseases like tuberculosis since they are excluded from the market and the government provides only a fraction of the cost of care to treat the disease.

21.6 The Impact of Public and Private Provision of Health Care on the Poor

In some ways, a review and assessment of the impact of the public and private provision of health care on the poor who seek care for communicable diseases, has already been suggested by the data and discussion that has taken place in earlier sections. In this section we try to explore this issue further.

Perhaps the most surprising findings from data and evidence are that those who seek health care in Pakistan, opt for the private sector rather than the public sector. More surprising, is the fact *that even the poor and 'extremely poor' prefer private medical/health care to government provision of care*. Clearly, people are voting with their feet. This is despite the fact that all broad macro indicators about the provision of health care in Pakistan have shown a considerable improvement in recent years and decades—see Table 21.13, although Table 21.13 shows serious gaps in the provision of basic government health services and facilities. Public health facilities are fairly widely available in Pakistan, yet it seems that people who require health care chose to avoid the public sector. Perhaps what is even more surprising, is that the little documentation

that is available suggests, that many of those who opt for private care also state that the quality of health/medical care in the private sector is not particularly better than that provided in the resource-constrained public sector.[60] It must also be recognized that this trend of moving from the public sector in health to the private sector, is a phenomenon not unique to Pakistan and is found to take place in many other developing countries as well as in South Asia.[61]

Table 21.13: Public Health Facilities in Pakistan: 1990, 2004

	1990	2004
Hospitals	756	916
Dispensaries	3795	4582
BHUs, Sub-Health Centres	4213	5301
Maternity and Child Health Centres	1050	906
Rural Health Centres	459	552
TB Centres	220	289
Total Beds	72997	99908
Population/Bed	1480	1540
Registered Doctors	52794	113206
Population/Doctor	2082	1359
Registered Nurses	16948	48446
Population/Nurse	6374	3175

Source: Government of Pakistan, *Pakistan Economic Survey 2004–05* (Islamabad: GOP, 2005), 91.

What is surprising from Table 21.14 is not so much that rural areas do not have sufficient health/medical facilities in their vicinity, but that there are so many private facilities and private sector health and medical personnel available. Even in the very remote rural areas of Balochistan where government facilities are not available, there are private health facilities. Despite the growing number of public health (government facilities)—Table 21.13—it is the private sector which dominates, and the trend continues in favour of the private sector rather than the public sector.

A key explanation for why almost 75–80 per cent of the population, which includes the poor who access health/ medical facilities use private sector facilities, is said to be due to the long 'distance to government hospitals and the unavailability of medicines and public health providers'; other reasons are said to include 'uncooperative staff, inability of providers to treat complications and the unavailability of doctors at these facilities'.[62] This trend towards the private sector does not necessarily suggest that the private sector provides good or better care than the public sector. In fact, the 'number of traditional providers of healthcare [sic.] greatly exceeds that of those with formal training, especially in rural areas'.[63] (However, data presented above from the National Health Survey suggests that very few people actually go to 'traditional' providers and most go to private doctors).[64] As Table 21.15 shows, even for a recurring common problem like diarrhoea, the most utilized health facilities are private practitioners, even in rural areas. What is also worth observing from this table is the fact that a substantial proportion of the rural inhabitants choose (or because they do not have a choice, are forced to) not to seek consultation. In fact the proportion of those who 'choose' not to consult is greater than those who actually go to government facilities; this could be, as earlier tables show, due to the unavailability of any health/ medical care provider or facility in the area closest to them, or another likely explanation would be that in the rural areas people do not consider it important to seek treatment for as common a problem—and particularly chronic amongst the poor—as diarrhoea.

21.7 The Role of Government in the Control of Communicable Diseases[66]

A critical distinction and dividing line emerges between the private and public sector when it comes to the provision of preventive care and to the provision of immunization services, and in the broader role of the control of communicable diseases. The market-driven private for-profit sector, for

Table 21.14: Health Facilities in Rural Areas by Province: 2001

	Percentage of rural households with facilities present in their village				
	Punjab	Sindh	NWFP	Balochistan	Pakistan
Govt Hospital	3	1	3	0	2
Govt Dispensary	11	16	11	19	12
Basic Health Unit	18	11	33	12	18
Lady Health Worker	80	36	44	21	62
Private Hospital	5	3	1	1	4
Private Dispensary	13	16	11	3	13
Private Practitioner	21	22	30	6	22
Compounder/Nurse	33	19	58	5	32
Hakim/Homeopath	41	16	34	0	33

Source: Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 189.

Table 21.15: Type of Practitioner Consulted for Diarrhoea Treatment (percentages)[65]

	Private Practitioner	Compounder/ Chemist	Govt Hospital/ Dispensary	Other	No one consulted
Urban	60	3	18	6	13
Rural	45	10	18	5	19

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 189.

the most part, is not involved in preventive measures—except, notably, family planning—and nor in the provision of immunization related services. Also, the privates sector is not involved in the provision of non-medical related interventions in the health sector, such as the provision of water and sanitation, except for some exceptions, where water is sold to the public particularly in urban areas where government services have failed to reach the population (although this is probably not a comparable case of private sector provision of services in the same sense in which medical care is provided); in the case of sanitation and sewerage facilities, government failure has forced slum-dwellers to take matters into their own hands through self-help and NGO-led initiatives. In the more traditional meaning of the prevention of communicable diseases, the for-profit private sector is absent and the role of the government is critical, both in making interventions and in laying down guidelines and policies. However, one must emphasize that in 2012/13, after the implementation of the devolved Eighteenth Amendment, many of the policies initiated at the federal government level have either been passed on to the provinces, or terminated. In fact, there is considerable dispute about the ownership of such programmes by the provinces, some of which have been reluctant to take over formerly federal programmes. Moreover, many of the targets set by the Millennium Development Goals till 2015, have become benchmarks to be achieved—see Chapter 20 for more on the Millennium Development Goals set for Pakistan.

21.7.1 The National Health Policy 2001

The Ministry of Health, Government of Pakistan, in its *National Health Policy 2001: The Way Forward—An Agenda for Health Sector Reform*, released in December 2001, laid down its vision and key features of the Health Policy. The government's new policy was based on the following essential features: health sector investments were to be seen as part of the government's Poverty Alleviation Plan; primary and secondary sectors were to get priority attention over tertiary care; and, good governance was to be a pillar on which quality care was to be achieved.

In light of these broad goals, ten specific areas of reform were identified along with their implementation modalities. These ten areas focused on:

- The reduction of the widespread prevalence of communicable diseases, which include the EPI cluster of childhood diseases, Tuberculosis, Malaria, Hepatitis-B, and HIV-AIDS. Much of this emphasis was to be through the National EPI immunization programmes, and new national programmes were to start in TB and Malaria, with an enlargement of the HIV-AIDS programme.
- In order to address deficiencies in primary and secondary health care at the BHU/RHC level, trained Lady Health Workers (LHWs) were to be utilized to cover the un-served population at the primary, first contact, level.
- The Devolution Plan was to be used to improve quality of service and care provided by District Health Officers at the district level.
- In order to promote gender equity in the health sector, reproductive health services were to be provided to childbearing women at their doorstep. The Lady Health Workers (LHWs) were to be instrumental in this goal.
- Nutrition supplements were to be provided to the target population.
- A greater link between the Teaching Hospitals and the district level health facilities was envisaged.
- Better regulation was to be devised for the private medical sector to improve its standard and service.
- Greater awareness was to be created amongst the public regarding public health issues.
- The pharmaceutical sector was to be improved for better quality of affordable drugs.
- A Policy Analysis and Research Unit was to be set up in the Ministry of Health.

The Health Policy 2001 set targets and a time-frame for each of the key areas identified, with a ten-year focus. In May 2003, the Ministry of Health published its *Progress on Agenda for Health Sector Reforms* document. This document gave a detailed up-date on each of the ten areas, showing what all had been achieved as well as details of which steps had been taken to achieve targets, such as vaccines received, LHWs trained, contraceptives distributed, as well as information on how much had been spent in different areas and who had supported that funding. In addition, the May 2003 document highlights some new initiatives and National Programmes which had been, or were in, the process of being initiated. The core focus of the Government of Pakistan's Health and Population Welfare sector rested on the support to and strengthening of, the LHWs programme, the EPI programme, and the strengthening of institutions with linkages between different tiers of services.[67]

According to a recent study, despite the fact there had been some progress over the last three decades in the reduction of infant and child mortality, the extension of immunization coverage and there has been an improvement in the nutritional status of children, 'Pakistan today stands

amongst those countries with the worst record in terms of infant and child health and does poorly on most of these indicators in comparison with other South Asian neighbours'.[68] In addition within Pakistan, gender inequalities in the provision of health care persist, as do differences in rural/urban location, and 'income-based disparities remain and contribute directly to the deaths of many infants and children each year'.[69] Numerous vertical programmes—those programmes that were administered and controlled largely by the Federal Government, unlike most other health sector initiatives which were the responsibility of Provincial and District Governments—included the Extended Programme of Immunization, Diarrhoeal Control Programme, Malaria Control Programme, National AIDS Control Programme, National Tuberculosis Programme, and the Child Nutrition Programme.

21.7.2 The Extended Programme of Immunization

Perhaps the best-known and most successful of interventions regarding communicable diseases by the government is the Extended Programme of Immunization (EPI) started in the late 1970s; Tables 21.16–21.18 show the trends in the immunization rates over the last few years. The EPI programmes was successful up to the early 1990s, but then from '1992 to 1995 the EPI coverage declined to 50 per cent due to lack of funds and withdrawal of donor support'.[70] The number of outreach centres, vaccinators, and other EPI related staff and facilities, have remained 'more or less the same as in 1995'.[71] The government's immunization programmes deal with the following seven diseases: pertussis, tetanus, diphtheria, poliomyelitis, hepatitis B, measles and tuberculosis. Tables 21.16–21.18, which show the most important and largest government intervention in an attempt to control communicable disease, reveal a number of important facts. They show that there has been a steady increase in immunization coverage across Pakistan, except in Balochistan, where there had been a decline. In urban areas there had been a sharp increase of coverage, although in rural areas the coverage has stagnated since 1995. And, as we keep showing elsewhere in this Chapter, income (or poverty) has a considerable impact on health related factors: Table 21.18 shows that children from higher income quintiles have higher immunization coverage compared to those from lower income groups, where there is a significant difference in immunization rates with respect to income, in urban areas. Moreover, the relationship between non-health related factors also shows up in this context, where women who have higher literacy rates, and who tend to come from better-off households, have the ability to afford the best quality of care for their children, and also ensure that their children are immunized.[72] The government's EPI targets for 2005 included the complete eradication of poliomyelitis and the elimination of neo-natal tetanus, and a reduction of all the other diseases which are part of the EPI.[73]

Table 21.16: Trends in Immunization Coverage in Pakistan: 1980–2000 (per cent of Children 12–23 Months)

Year	BCG	DTP3	POL3	Measles
1980	6	2	2	1
1985	62	30	30	38
1990	80	54	54	50
1995	73	58	58	47
2000	67	61	61	56

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 186.

Table 21.17: Immunization Coverage by Locality (per cent of Children 12–23 Months)

Region	1995–96	1998–99	2001–02
Pakistan	45	49	53
Urban areas	50	64	70
Rural areas	44	45	46
Punjab	47	55	57
Sindh	44	38	45
NWFP	39	54	57
Balochistan	56	34	24

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 186.

Table 21.18: Immunization Coverage by Income Quintile (per cent of Children 12–23 Months)

Income Quintile	Urban	Rural
First	28	18
Second	34	21
Third	40	21
Fourth	44	27
Fifth	60	27

Source: Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 186.

Apart from the EPI programme which formed a key pillar in the government's preventive measures in the control of communicable diseases, the Malaria Control Programme, the National AIDS Control Programme, the National ARI Control Programme and the National Tuberculosis Control Programme constituted, along with the Lady Health Workers programme, the package to control communicable diseases in Pakistan.

The National AIDS Control Programme was established for the prevention and control of the spread of HIV infection in the country. By April 2003, the total number of reported HIV cases was 1785 and of AIDS 235; however, the World Health Organization/UNAIDS estimated that there were a total of 70–80,000 HIV positive cases in Pakistan. [74] The main interventions regarding the programme relate to the design and delivery of a defined package of services to the vulnerable groups; the package included 'primary health care, access to adequate information and education, prevention and treatment of Sexually Transmitted Infections (STIs), skill development and provision of Voluntary Counseling [sic.]

and Testing facilities'.[75] AIDS patients require Anti-Retroviral Therapy (ART), which delays the occurrence of death by a few years. Estimates in Pakistan show that 10,000 of the 70,000 (as per UNAIDS estimates) sufferers of AIDS require ART, but only 100 (0.1 per cent) received this treatment in Pakistan as of June 2003.[76] The cost of the annual ART treatment in the form of Anti-Retroviral Drugs (ARV) has been reduced from US$15,000 to US$140; the Government of Pakistan had also decided to provide free access of ARV to HIV/AIDS patients at the end of 2004.[77] However, the May 2005 *Annual Report of the Director General Health*, stated that 'currently there is no mechanism in place in the country for procurement of anti-retroviral drugs by the government'.[78]

The five-year Roll-Back Malaria (RBM) Programme part of the broader Malaria Control Programme had, as its overall objective, to achieve the WHO global RBM target of fifty per cent reduction in the malaria burden by 2010. There are 500,000 cases of malaria annually, and the cost of the RBM plan was US$4.1 million, which focuses on 43 high-risk districts in all the provinces of the country.[79]

21.7.3 The National Tuberculosis Control Programme

The National Tuberculosis Control Programme (NTP) was initiated in 1996, and was supposed to run for a period of five years from 1996–2001. The targets for tuberculosis control were a cure rate of an overly ambitious 85 per cent, and a case detection rate once the 85 per cent target cure rate had been reached, of 70 per cent. The strategy was supposed to provide DOTS for all sputum smear positive cases. The implementation of the NTP was meant to be phased across the five years, with a cumulative population coverage of 8.5 per cent in the first year (which was to be 1996 in the original programme), 17 per cent by 1997, 37 per cent by 1998, 71 per cent by 1999 and complete coverage by the year 2000. By the year 2000, the Programme was supposed to have an integrated set up as part of the structure of the general health services of the country, decentralized to each of the 118 districts. The focus of the TB Control Programme was supposed to be DOTS, provided by the health facility nearest to the patient's home. When a patient was unable to attend a health facility, a community supervisor would provide DOTS at the patient's home. The cost of the National Tuberculosis Control Programme in 1996, was estimated to be $31.2 million. This Programme and its cost, were critically dependent upon the existing health care structure across Pakistan. However, even after the WHO Global Emergency had been declared in 1993, Pakistan's Ministry of Health still had a long way to go in terms of operationalising its National Tuberculosis Control Programme, the guidelines for which were ready, but were lying wasted. If this was not already bad enough, at the end of 1997, the Government of Pakistan, yet again, decided to address the problem of tuberculosis, from a national level.

A donor-funded Social Action Programme Project (SAPP) was supported by the Government of Pakistan which commenced in 1993 and was completed in 1996–97. In this SAPP Phase 1, four areas had been identified which received donor and Government of Pakistan funding. These were: Primary Health, Primary Education, Rural Water Supply and Sanitation, and Family Planning and Population Welfare.[80] After the three year SAPP 1 concluded, the government and the donors decided to launch SAPP 2 for a further period of three years, with more or less the same areas of focus. However, SAPP 2 had included a component of the TB programme.

Originally, SAPP 2 was supposed to include a national tuberculosis programme 'jointly sponsored and financed by the Federal Government and the provinces/areas, with a focus on switching to the WHO-recommended DOTS approach for the treatment of TB. However, it has proven difficult to find a formula for sharing the costs of the programme between the Federal Government and the provinces/areas'.[81] The proposed programme proposal was rejected by the multi-donor Appraisal Mission because the proposal was 'too limited, as it mainly focuses on treatment'. Instead, a small Technical-Assistance TB component was added on to SAPP 2. This component included the following elements: '(i) the development of a comprehensive national strategy for TB . . . which would incorporate the DOTS approach, but would also consider wider issues such as health education/communication aspects, and involvement of private sector; (ii) the preparation of a project proposal for a comprehensive project to implement the strategy, to be submitted to interested donors for possible funding; and (iii) . . . the development of a few pilot projects related to the introduction of the DOTS approach'.[82]

In some ways, the SAPP 2 component incorporating TB differed little from the 1995 National Tuberculosis Control Programme. However, the cost of the SAPP 2 TB proposal was a mere $260,000 or *less than one per cent* of the earlier NTP! More importantly, however, not only did the TB component of SAPP 2 not improve or add to the 1995/96 NTP, but in 1998 (when SAPP 2 commenced), five years after WHO's Global Emergency, the Government of Pakistan was thinking primarily of *'the preparation of a project proposal'*, and a *'few pilot projects related to DOTS'*. Most of the emphasis of the TB component in SAPP 2, consisted of holding a number of workshops and producing a draft document for (yet another) National TB Control Policy. With the end of SAPP 2 and with the launch of the NTP, the Programme was now operational in 79 districts and Lady Health Workers were mainly utilized to provide door-to-door services. The NTP had brought down its ambitious targets to 70 per cent case detection, an 85 per cent cure rate and an ambitious 100 per cent coverage of DOTS all over the country by 2005; a reduction in tuberculosis-related morbidity and mortality by half, was also one of the overall objectives of the NTP.[83]

21.7.4 The Lady Health Workers Programme

The Lady Health Workers Programme was conceived in 1993 and launched in April 1994 by the Government of Pakistan under the name 'The Prime Minister's Programme for Family Planning and Primary Health Care', which was later changed to 'The National Programme for Primary Health Care and

Family Planning', now usually known as the Lady Health Workers (LHW) Programme. The LHWs Programme had as its objective the public financing and provision of basic community health services to all rural villages and poor urban areas in the country. The objectives in establishing the programme included the following: to address the primary health care problems of the community, providing promotive, preventive, curative and rehabilitative services to which the entire population had effective access; bring about community participation through creation of awareness, changing of attitudes, organization and mobilization of support; improve the utilization of health facilities by bridging the gap between the community and health services through LHWs; and, expand the family planning services availability in urban low income areas and rural areas. The Programme was seen as a key intervention in reproductive health/family planning at the local level, was meant to be gender sensitive, where more women were not just the clients but were also employed, and also focused on children. The LHW Programme was seen to be a multifaceted, multi-purpose programme addressing many of Pakistan's primary and basic health issues.

Around 100,000 LHWs were employed in the programme and there had been an annual increase in recruitment over the years. 17,000 were recruited in August 2001 to fill vacancies and to expand the programme. 11,000 women working in basic health in the Ministry of Health under different programmes—particularly Village-Based Family Planning Workers—were transferred to the LHW programme, and the programme finds mention—in fact, it is a key pillar—of both the government's National Health Policy as well as the Poverty Reduction Strategy Chapter. The LHW is considered to be a 'strong' national programme, much of which has been financed up till recently, with small amounts of donor money. However, since fiscal year 2000/01, allocations to the LHW programme have been insufficient covering only salary costs. This means that without donor support, LHWs would have minimal supplies of contraceptives and medicines and supervision standards would have suffered. Clearly, the LHW programme would have been under threat had donor support not been forthcoming.

Both the National Health Policy and the health strategy mapped out in the Poverty Reduction Strategy Paper (PRSP), identify the LHW Programme (LHWP) as 'the primary means in the public sector of promoting and delivering preventive and basic curative health services within the community'. It also has a strong pro-poor focus and is meant to address gender inequities in health as well. An external evaluation of the LHWP was able to find evidence that the Programme 'has been able to supply a service to individuals and a large proportion of these individuals are poor. Above all the LHWP has been able to buck the international trend by providing a service that has had impact on health outcomes'.[84] The evaluation identifies the impacts that the LHWP has had which include: a large and positive impact of childhood vaccination rates; a large and positive impact on reversible methods of contraception especially in rural areas, and on all methods of modern contraception in rural areas; an increased uptake of antenatal services; the increased provision of iron tablets to pregnant women; increased levels of child growth monitoring; lower rates of childhood diarrhoea; and, more positive attitudes to family planning. Amongst the weaknesses of the Programme that had been identified, were: unrealistic targets for the number of employed LHWs; insufficient funds; quality control; management and supervision issues; and continued government support and sponsorship from senior level officials. The evaluation also revealed that the quality of care offered by LHWs was variable, with 'up to half of LHWs displaying weaknesses in different aspects of their professional knowledge'. However, the most serious deficiency with the Programme was identified as the shortages of drugs and contraceptives, with fewer than a quarter LHWs receiving their full allocation of these items, undermining the credibility of the entire Programme.

There is a valid understanding amongst many that through a well-functioning LHW Programme, up to 70–80 million people throughout Pakistan, most of them poor, would have access to better health services. Through the intervention of the LHWs, family planning use would increase, more children would benefit from oral rehydration therapy and can be treated in their homes for acute respiratory infections; women are also expected to receive better ante-natal health care. This pro-women and especially, poor women, focus is emphasized since the LHW Programme is perhaps the only opportunity many women have to access preventive and basic curative care without having to leave their homes. Contact with LHWs in the community is also expected to bring about greater awareness related to health education and about immunization and other child-related issues. The population coverage of the Programme increased from 30 per cent in 1999 to 48 per cent in 2006.

21.8 Intervening in the Health-Poverty Nexus: The World Health Organization Commission on Macroeconomics and Health

In this and the next Section, we suggest ways of intervening in the health-poverty nexus, where we attempt to look at the perspective of both, achieving high and sustainable growth in Pakistan while addressing issues of poverty reduction in light of health constraints and opportunities. This is done in two parts where, in this Section, we look at the broad, more generic, conclusions drawn from the influential Report of the World Health Organization's Commission on Macroeconomics and Health which examines the link between health, poverty and economic growth, and also identifies economic and financial implications and requirements of trying to break the ill-health-poverty nexus. In Section 21.9, we look at the case of Pakistan where we try to examine issues and ideas which incorporate some of the main ideas of the Commission's Report, but also force us to rethink much conventional wisdom.

The Commission on Macroeconomics and Health (CMH) was established by the Director of the World Health Organization in January 2000 to assess the place of health in

global economic development. The Commission, comprised a number of economists, policymakers and public health specialists, and submitted its findings in November 2001. This section presents the key features of the Report of the Commission.[85]

The Report focused mainly on the 2.5 billion people who lived in low-income countries and examined their health and demographic profiles. This forty per cent of the population had far lower life expectancies and far higher age-adjusted mortality rates than the rest of the world, in some cases by very significant extents. For most of these countries and their governments, the most critical public health task was to reduce these high mortality rates, to control communicable diseases and to improve maternal and child health. In these populations of low-income countries, the main causes of avoidable death were HIV/AIDS, malaria, tuberculosis, childhood infectious diseases, maternal and perinatal conditions, micronutrient deficiencies, and tobacco-related illnesses. Health specialists believed that if these conditions of disease and ill-health were controlled along with enhanced programmes of family planning, poor families—which make up the bulk of these countries—would not only enjoy longer lives which are healthier and more productive, but they would also choose to have fewer children since they would realize that their children would survive and they would invest far more in the education and health of each child. Women in poorer countries and poorer communities are particularly vulnerable, having to bear the burden of diseases as well as having to care for the family and in most cases, to earn income, often as the sole earner. Many of these illnesses have a higher burden on the conditions of women and if they were eliminated or reduced, the health and well-being of women would also be considerably improved having numerous positive consequences on their own lives and those of their family. Moreover, the close link between health, illness, and the ability to work, suggests that the reduction in the incidence of these common and preventable diseases, would translate into higher incomes, higher economic growth and reduced population growth.

Given the epidemiological profile of the low-income countries, it is not surprising that the Commission focused mainly on communicable diseases and maternal and perinatal health. However, due to the demographic and epidemiological transition, non-communicable diseases (NCDs) are gaining further importance in poor and low-income countries, while for middle-income and growing countries, communicable diseases cause fewer deaths than do non-communicable diseases which have now become the highest priority for health and policy interventions. Many of the common NCDs such as cardiovascular disease, diabetes, mental illness and cancers, can be effectively addressed by relatively low-cost interventions, especially using preventive actions relating to diet, smoking and lifestyle changes. The Commission Report argued that while it recognizes global trends and phenomena, each country needs to analyse its own health priorities based on detailed and continually updated epidemiological evidence. The Report argued for an outcome-oriented health system where approaches were required to scale up the health system to provide interventions for communicable diseases and reproductive health, which would also result in improvements in care for non-communicable diseases.

With the Millennium Development Goals (MDGs) now an important target and objective for the entire world and for each country to achieve, the CMH Report questions the optimism of those who argue that it is just a matter of time before the mortality rates in the low-income countries would converge with those of the rich countries. The Commission Report argued that the existing and worsening burden of disease in low-income countries would slow the economic growth that is presumed to solve the health problems—there is a crude relationship which shows that as economic growth takes place, the burden of disease changes and the diseases of poverty are done away with and replaced by non-communicable diseases. Further evidence suggests that economic growth is very important and perhaps even necessary, but is not sufficient and far from enough on its own. The evidence for this is revealed by the fact that health indicators vary widely across the same income level. In 2002, the MDGs for infant mortality were lagging for 73 countries, while 66 countries were far behind for meeting the MDGs for child mortality.

In dealing with the specific issue of the ability of low-income countries to afford to fund the health systems out of their own resources, the Commission examined whether these countries could eliminate wasteful spending in health and other areas, and found that while waste does exist and needs to be addressed, it is poverty which imposes a basic financial constraint. Poor countries were required to improve health-sector management, review the tilt and emphasis of existing health-sector programmes, and were expected to find ways and means to raise domestic resources specifically for the health sector. The Commission believed that on average, low- and middle-income countries must increase their health outlays by 1 per cent of GNP by 2007, raising it a further 2 per cent by 2015 compared to existing levels. There was also a need to make public spending better targeted towards the poor with priorities set on specific epidemiological and economic evidence. Proposals for prepaid community financing schemes replacing private-out-of-pocket spending in some cases were also recommended. Nevertheless, there was the realization that in order to meet MDGs, there was going to be a considerable resource gap in some cases, which only donors could fill.

While the Commission advocated greatly increased investment in the health sector, it also stressed the need for complementary additional investments in areas which have an important impact on poverty alleviation as well as on health. A more holistic approach related to poverty alleviation which included a focus on water, sanitation, education and agricultural improvement, was supported because they all made significant contributions to the health sector and to health status. A critical element of the core insight of the Commission's Report was the central importance of *public health* for poverty reduction and economic growth. Public investments in health had to be raised significantly before any impact on the health outcomes could be expected.

Another of the key findings of the Commission of Macroeconomics on Health of the WHO has been the

compelling empirical findings and evidence, which most people intuitively arrive upon, that better health for the poor was not only an important goal in its own right, but could act as a major catalyst for economic development and poverty reduction. *There is a close and intrinsically determined relationship, which flows in all directions, between health, poverty and economic development.* This is a much researched and empirically founded relationship which shows that the poor are likely to be ill more often than the non-poor and that on account of their poverty (and ill-health) the country's economic development would remain unfulfilled. At a personal/individual or household level, even if the poor were able to find work and earn some income, the fact that they were more than likely to be unhealthy and ill on account of their poverty, would hamper their ability to work efficiently and thus they would get wages at below their potential and below their marginal productivity level. Similarly, while the poor were likely to be ill, the chronically ill and those suffering from the main killer and debilitating diseases in low-income countries like HIV/AIDS, malaria and tuberculosis, were likely to be poor since, on account of their illness, they would not have the physical ability to get work or perform work adequately.

In more macro terms, it is not surprising to find this high correlation between poverty, ill-health and underdevelopment. The poverty/disease nexus causes underdevelopment and constrains economic growth. For economic growth to take place and reach the potential of any country, it is necessary that this nexus be broken, either by improvements in health status of the people, particularly the poor, by better service delivery, better targeting and a host of other factors; or/and, poverty needs to be reduced and eliminated so that once out of poverty, individuals can have better health and play a far more productive role in economic development. Ideally, and as the Commission on Macroeconomics and Health argues, poverty reduction and health improvements should take place together and simultaneously: poor countries cannot afford and either/or.

There are numerous direct and indirect costs associated with ill-health, and include the loss of personal income and national income, as well as under-investment in children's education and reduction in the sources of resource mobilization. Continuing disease episodes of workers adversely affect the productivity of firms, which increases the costs of production. Evidence has shown that a healthy labour force, which is also better paid, improves the capacity of the firm to compete in the international market.

The Commission on Macroeconomics and Health shows that poverty would be more effectively reduced if investment in other sectors was increased as well. The need for complementary investments in education, water and sanitation and other sectors that will have an impact on health is clearly recognized in the Commission's Report, taking a more holistic approach to both poverty eradication and to improving the health profile. There is a clear and unambiguous impact of all effective and successful poverty-reduction efforts on health, while the role of health is fundamental to the success of sustainable development efforts. The need to position health centrally to any efforts of development cannot be overemphasized. Health is a cornerstone of economic growth and social development.

While this relationship between health (or more importantly, ill-health) poverty and underdevelopment is clear, the not so surprising finding is that poorer countries with low-income and low-development, have far fewer financial resources in general, and for the health sector, in particular. The Commission had also provided evidence that the level of spending on health in low-income countries was insufficient to address the challenges that they face. A minimum level of financing needed to cover essential interventions, including HIV/AIDS, of between US$30–40 per capita was required, in contrast with actual levels of spending of the order of US$13 per person in the least developed countries and US$24 in other low-income countries. Clearly, the ability to fund minimum required spending levels to cater for a substantial and vulnerable population, is beyond the scope of many countries showing a very clear resource gap.

The WHO Commission on Macroeconomics and Health argued that: 'we believe that it is feasible, on average, for low- and middle-income countries to increase budgetary outlays for health by 1 per cent of GNP by 2007 and 2 per cent of GNP by 2015'. It is important to emphasize that the WHO feels that *at least* an additional one per cent of GNP should be spent on health over the next four years and another additional one per cent between 2007–15. By that account, Pakistan would need to increase its current health sector spending by 143 per cent in the immediate case, and 285 per cent by 2015. The CMH Report suggested that on average developing countries need to spend US$23 per capita annually on the health sector. Pakistan, spending US$16, would need to find an additional US$7 per person—about US$1 billion, from both private and public sources—to reach that minimum target.

On the face of it, this huge increase seems an impossibility given Pakistan's past history of having to balance its income and expenditure patterns. Pakistan's annual budget consists largely of interest payments and military expenditure, with very little left over for development purposes. Hence, the quite dramatic fall of development expenditure over the years since the 1980s. However, as we argue elsewhere—see Chapter 18—Pakistan's economic situation changed dramatically after 9/11, largely because Pakistan received considerable concessions on its outstanding debt having an impact on interest payments. Debt rescheduling, re-profiling and debt write-off gave Pakistan an unprecedented room to manoeuvre and made resources available which would have otherwise gone to repay loans.[86]

It was this 'fiscal space' that had been created which was Pakistan's biggest window of opportunity and may have been the one major possibility and opportunity for Pakistan to redress its social sector deficit and fill the social sector gap. In some ways, this new found fiscal space since 2003, was more than sufficient to plug the gaps in the social sector and increase spending as per WHO guidelines mentioned above. It was clearly possible for the Government of Pakistan to provide the additional 1 percentage point of GDP required for the health sector as per the CMH guidelines. This was inconceivable prior to 9/11 and if there was ever a need for a clear understanding in government of the urgency in meeting

the social deficit, this was perhaps the best opportunity to come Pakistan's way in many years. By wasting this opportunity, the Musharraf-Shaukat Aziz government did a grave injustice to the people of Pakistan, particularly the poor who make up one-third of the population. Since the windfall of 9/11, things have deteriorated further, in terms of fiscal space and government inability to spend. As we show in Chapter 10, the tax-to-GDP ratio and the increasing debt and interest payments, limit the amount available for development, a figure which has fallen markedly over the last few decades.

Pakistan is faced with a crisis not just in the health sector, but more broadly related to unacceptably high rates of poverty and growing rates of unemployment. Hence, every issue that is related to either health, poverty or development will have an impact on each other. A poverty-reduction strategy which is able to lower the poverty rate will have many externalities, not least, improving the health status of the population. A multisectoral policy is required to tackle all issues related to development, poverty and health care.

While the tax-to-GDP ratio in Pakistan is amongst the lowest in the world, we do not advocate a blanket tax on the entire population even if it were to be used specifically for the health sector since the burden of indirect taxes falls unequally on the poor. Instead, better tax management and scrutiny can raise additional resources from existing government revenue sources—see Chapter 10. Moreover, if taxes need to be raised so that the health sector budget can be increased, it is far preferable to raise additional revenue from the rich and subsidize the poor. Increased direct taxation is one obvious way forward, as is the taxation of profit-making health services and facilities which abound in urban centres across Pakistan.

Probably the most important precondition for Pakistan meeting its resource gap and filling its social sector gap is the political commitment required from policymakers. In order to provide additional resources for the health sector—without which it is not possible to accomplish the Millennium Development Goals—policymakers at the federal and provincial levels need to be required to make firm commitments for additional funding. The relationship between poverty, health, and underdevelopment needs a deeper understanding by policymakers so that they realize the urgency in addressing these problems. If the health issue is not addressed soon, poverty will persist and will not fall to manageable levels and the high growth rates targeted and required for development will not be forthcoming. Policymakers need to be convinced that by increasing spending on the health sector, development will increase and there will be greater welfare for the people.

21.9 Rethinking Intervention in the Health-Poverty Nexus: Health, or Poverty?

The concluding section of this chapter, makes a departure from the one prior to this and reconsiders possibilities and options of interventions in the health-poverty nexus. It raises the key question that given the close link between the two, whether interventions should come in the health sector or under the more general rubric of poverty alleviation—see also Chapter 22. The most important points that emerge from the data and discussion from earlier sections, can perhaps best be summarized as follows.

Almost four times as many people visit private health/medical practitioners than the government health facilities, a trend that has risen in recent years. Even the poor and the extremely poor, contrary to expectations, also overwhelmingly access private sector facilities, both in rural and urban areas. Clearly, the private sector dominates the medical/health sector structure and model in Pakistan. However, in the case of preventive care, the main responsibility lies with the public sector and the for-profit private sector is restricted primarily to curative care. There is a strong relationship between poverty and ill-health, where the poor tend to be ill for longer and suffer a greater burden of disease related to communicable and preventable diseases. This relationship between the disease profile and poverty is reinforced through the relationship between poverty and non-medical factors that have an impact on well-being. At the same time, non-medical factors also have an impact on health and disease, showing a close relationship between health, poverty and factors such as education, water and sanitation, housing, etc. While there are regional and class disparities in the health sector, women tend to suffer the greater brunt of these inequalities. Moreover, many of the non-medical interventions that can improve health outcomes, are related to women. It is in these broad parameters in which intervening in the health-poverty nexus needs to be rethought.

Perhaps the most common intervention, which almost anyone who deals with the social sector in any developing country would suggest, is that proposed by the World Health Organization's Commission on the Macroeconomics of Health as discussed in Section 21.8. An increase in funding to the health sector is presumed to be a minimum requirement for any improvement in health outcomes; the assumption is that the funds being spent are just not enough and they ought to be increased. Along with this, there is also the recommendation made that there is far greater need for better governance and administration related to delivery, i.e. that with the increased financial allocation, there should be better monitoring of that money and that there should be greater participation by those who deliver and those who use health services, etc. All such recommendations are, perhaps justified in a generic sense for almost all countries. The argument is that such interventions, even if they do not make matters very much better, will probably not make matters much worse.

If poverty is said to result in conditions that also give rise to ill-health and ill-health causes individuals and households to persist in (or slide into) poverty, one needs to make an intervention in order to break this closely connected relationship. It is necessary to assess whether poverty alleviation interventions are more productive or whether investing in health improvement mechanisms will bring about better and faster returns, in terms of both, poverty

reduction and improved health status. Moreover, there is a need to examine the nature of health outcomes based upon interventions in the health/medical side, compared to those based upon non-medical interventions. Given limited and competing resources, there is a need to decide whether, for example, a Basic Health Unit needs to be set up near a village, or whether a school requires more rooms and teachers for girls, or whether the immediate goal would be to reduce water-borne diseases such as diarrhoea and dysentery by providing clean drinking water to a community. While all these interventions deal with the health sector alternatively, there might be valid arguments which emerge where poverty alleviation should be the main focus rather than health-related interventions. Arguments could be made which suggest that there might be a need to develop an employment programme, provide a food subsidy, provide microcredit, or develop a food-for-work programme in preference to (perhaps costlier) health-related interventions. One would need to ask whether there was any point in constructing yet another Basic Health Unit when not many of those who are ill will actually end up using it? Before such choices are made, there is a need to undertake some research into the costs and returns from a wide menu of options, and there is a need to rethink many of the assumed solutions to chronic problems. If the poverty-ill-health relationship is the main focus, then there is a need to understand how and why it is created and thrives, and then examine where best to break this relationship. Such choices will require considerable amount of expertise and research where informed and cost-efficient choices must be made.

Although the blanket recommendation to increase funding for the public health sector is made by all experts and politicians, the trend seen in Pakistan and elsewhere of users moving away from the public sector to private sector health/medical care, might not be reversed despite increased funding. Should the government under such circumstances, increase funding to the health sector—most of which goes on salaries and is directed towards tertiary care—even when the poor prefer to seek care from the market? Perhaps increased funding at the margin would be highly cost-inefficient and it could be that funding may not be the main constraint to greater utilization of health facilities. The little research that has been undertaken on the health sector shows, that many people prefer to go to private doctors even when they know that the service provided will not be much better than that provided free of charge at government outlets. It is quite possible that financial issues might not be the main constraint to increasing utilization, and an overhauling of the governance system in the health sector, resulting in better service to the clients, might be a more cost-effective choice, though more difficult to implement.

If an increase of funding in the health sector is not necessarily going to bring about improvements in the utilization rate of health services, perhaps it would be better to spend the existing and enhanced funds in different manner altogether. If the private sector dominates in terms of curative care, it might be more useful that the government funds are spent primarily on preventive and non-medical related investments, such as immunization, health education, and drinking water and sanitation facilities. The private sector providing curative care could do with far greater monitoring of standards and quality. By spending far more on preventive measures, the government would also be able to reduce many of the communicable diseases which afflict the poor, improving their health and allowing them to move out of poverty, and hence, reduce their need to seek assistance for medical care in the first case.

It is largely accepted that poverty breeds ill-health and ill-health maintains and perpetuates poverty, and the relationship between the two is far closer than that between say, education and poverty.[87] If indeed this is the case, then it is surprising that while there is considerable research and growing understanding about poverty in Pakistan, there is neither the recognition that the poverty-ill-health relationship deserves in government or academic circles, and perhaps therefore, there is neither the data nor research undertaken to understand issues critical in the health sector. As we show in earlier sections, the data on disease and other aspects of health care are incomplete, often incorrect, and highly insubstantial in order to clarify issues in order to intervene in the health sector precisely, cheaply and effectively.

One reason why there has not been any innovative rethinking about health delivery and about ways of improving health outcomes independently and those related to poverty, is because not enough data exists which would allow us to do so. For example, in a country where the private sector dominates the health care model by a ratio of 4:1, there is next to no reliable data regarding the private sector in health care. How then can one make plans for the health sector or given the close link between the two, for poverty alleviation? If the entire discussion regarding reforms in the health sector is made around the small and diminishing public health/ medical sector, and all interventions relate to the sector which has a minor role to play in health outcomes, it is perhaps not surprising that Pakistan's health profile remains as bad as it is.

In order to make policy decisions and interventions regarding either poverty or ill-health in Pakistan, it is high time that the close relationship between the two was acknowledged. Once this is recognized, it would then be necessary to understand how both perpetuate or prolong each other and to disentangle the nature of the links and relationships between the two. This would require far greater data and research which looked at the health sector and brought it in line with the research on poverty and brought health squarely into the poverty framework. Perhaps only then can one make choices between health interventions and/or poverty interventions, or between preventive health care and tertiary level care, between increased spending in the public health sector or a restructuring of its governance structure. In order to meet its Millennium Development Goals sooner rather than later, and to address many uncomplicated issues related to either poverty or to disease, it is imperative that there is a major rethink regarding policy options. Until then, it is improbable that neither poverty, nor the ill-health related to it, will be alleviated.

21.10 Summary and Further Reading

21.10.1 Summary

The main argument in this chapter is that health is a multidimensional concern and should not be looked at in isolation. The chapter makes the link between poverty and health, demonstrating how so many issues related with poverty—or those related to ill-health—are actually interlinked with each other. This is especially the case with regard to women and girls where, education, literacy, women's empowerment, and housing, all determine health and poverty. By educating girls, for example, one increases their life-chances and improves their health and subsequently of their children. The same interventions also help women, and hence households, to get out of poverty.

Although demands are made to increase government spending on the health sector, most of the expenditure in the health sector takes place in the private sector, even amongst the poor. This is a reflection on the state and quality of public sector health facilities and delivery, and as in many other sectors, shows how government facilities have failed. While the private sector caters to the needs of a majority, as in education, it is not adequately monitored or regulated and quality control is lacking. There is a need to improve the quality of care provided by the government and major reform in public sector health care is an urgent requirement. As the chapter shows, if the poor are more vulnerable to ill-health and to disease, a focus on poverty alleviation would also help in improving their health profile since both, poverty and health, are so closely tied. The chapter also makes the case for research in the health sector which focuses on issues of public health, since data constraints and the absence of health-related research are serious impediments to solutions to issues related to the sector.

21.10.2 Further Reading

As the chapter argues, there is insufficient research on the health sector in Pakistan, and hence, few publications. However, some publications worth studying include the following: Talib Lashari, *Pakistan's National Health Policy: Quest for a Vision* (Islamabad: The Network Publications, 2004); Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005); A G Tinker, *Improving Women's Health*, Human Development Network, Health, Nutrition and Population Series, (Washington DC: World Bank, 1998); World Bank, *Pakistan: Towards a Health Sector Strategy*, Report No 16995-PAK (Washington DC: World Bank, 1998); S Akbar Zaidi, *The Political Economy of Health Care in Pakistan* (Lahore: Vanguard, 1988); and Sania Nishtar, *Chocked Pipes: Reforming Pakistan's Mixed Health System* (Karachi: Oxford University Press, 2010).

Notes

1. This chapter is based on Zaidi, S. Akbar's, *The Poverty-Health Relationship in Pakistan, Pakistan Poverty Assessment Update*, Background Paper Series, Background Paper 6 (Islamabad: Asian Development Bank, November 2005).
2. For a list and for reviews, see for example: Zaidi, S. Akbar, *An Annotated Bibliography of Poverty in Pakistan* (Islamabad: UNDP, 1999); Naqvi, Zareen F, *Review of Literature on Poverty in Pakistan*, mimeo (Islamabad: World Bank, 2000); and Arif, G. M., *Poverty, Economic Growth and Inequality: A Review of Pakistan's Poverty Literature*, mimeo (Islamabad: Asian Development Bank, 2005).
3. Note that in this Chapter, we focus on issues of the health sector and the relationship between ill-health and poverty and not with the large number of issues dealing with poverty— which have been addressed in detail in Chapter 22.
4. Amongst the more recent publications which examine the health care system in Pakistan, see, Mahbub ul Haq Human Development Centre (MHHDC), *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005); Lashari, Talib, *Pakistan's National Health Policy: Quest for a Vision* (Islamabad: The Network Publications, 2004); and World Bank, *Pakistan: Towards a Health Sector Strategy*, Report No 16995-PAK (Washington DC/Islamabad: World Bank, 1998).
5. This data are drawn from different sets of UNDP and World Bank data bases.
6. It is worth pointing out that different data sources give different sets of statistics regarding the very basic data. The data for Pakistan in this table differs from that shown in other tables.
7. The total burden of disease is defined as the loss of healthy life in the form of premature deaths and disability due to all episodes of disease and injuries occurring in a given year. The total burden of disease in Pakistan is estimated by the World Health Organization to be 350 Disability Adjusted Life Years (DALYs) per 1000 population per year.
8. See Asian Development Bank, *Poverty in Pakistan: Issues, Causes and Institutional Responses* (Islamabad: ADB, 2002). In a section entitled 'Characteristics of the Poor', numerous attributes of the poor are listed and some of the 'key characteristics of the poor' include their education, demography, assets and sources of income, dependence on women's labour, and their vulnerability to environmental degradation. It is noticeable that there are no health/disease related characteristics mentioned which just accentuates the problem we have been talking about.
9. Although this table is almost three decades old, it is still one of the better sources of data available. Current data of this nature is no longer collected.
10. Tinker, A. G., *Improving Women's Health*, Human Development Network, Health, Nutrition and Population Series (Washington DC: World Bank, 1998), cited in Mahbub ul Haq Human Development Centre, *Human Development*

in South Asia 2004: The Health Challenge (Karachi: Oxford University Press, 2005), 179.
11. Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 180.
12. Ibid.
13. Ibid.
14. Ibid.
15. Pakistan Medical Research Council, *National Health Survey of Pakistan: Health Profile of the People of Pakistan*, Islamabad, 1998, cited in Hussain, Akmal, *Pakistan: National Human Development Report 2003* (Karachi: Oxford University Press, 2003), 19–20.
16. Cited in Hussain, Akmal, op. cit., 69.
17. Hussain, Akmal, op. cit., 20.
18. Ibid.
19. Ibid. 69.
20. Pakistan Medical Research Council, *National Health Survey of Pakistan: Health Profile of the People of Pakistan*, (Islamabad: PMRC, 1998), 4.
21. Ibid. 4.
22. The reasons why women visit health/medical care practitioners more often than men relate to a number of factors. For one, reproductive health and child-bearing issues result in increased contact for women than men; and, women also take children to health/medical facilities and may they also consult during the same visit. See Ibid. 4.
23. Ibid. 6.
24. Ibid.
25. It is very probable that this proportion has increased very substantially over the last decade as the provision of doctors has increased.
26. Ibid. 10.
27. Ibid. 13.
28. World Bank, *Pakistan Poverty Assessment* (Islamabad: World Bank, 2002), 64.
29. Hussain, Akmal, op. cit., 70.
30. Mahbub ul Haq Human Development Centre, *Human Development in South Asia 2004: The Health Challenge* (Karachi: Oxford University Press, 2005), 179.
31. Perhaps what is even more surprising is that in India's case, the proportion is even higher at 83 per cent; moreover, data from India shows that 93 per cent of hospitals and 63 per cent of hospital beds are in the private sector. The private sector in India accounts for 82 per cent of all outpatient care at the all-India level and 56 per cent of all inpatient care. See Ibid. 165.
32. Hussain, Akmal, op. cit., 69.
33. Asian Development Bank, op. cit., 25.
34. Ibid.
35. World Bank, op. cit., 36.
36. Ibid.
37. Ibid.
38. See Arif, G. M., op. cit., and Gazdar, Haris, *Scoping Paper: The Determinants and Drivers of Poverty Reduction in Rural Pakistan*, mimeo (Islamabad: Asian Development Bank, 2005).
39. Even in this case one can add that charity and other means of social support might be available to those who are more generally excluded.
40. MHHDC, op. cit., 186.
41. Government of Pakistan, *Pakistan Economic Survey 2011–12* (Islamabad, 2005), 100.
42. Ibid. 104.
43. Brenzel, Logan and S. Akbar Zaidi, *Methods in the Cost Study of Health Services in Pakistan*, mimeo (Washington DC/ Islamabad: World Bank, 1996). The World Bank's *Pakistan: Health Sector Strategy*, Report No 16695-PAK (Washington DC: World Bank, 1998), makes extensive use of this study and is more easily accessible than the original study.
44. Zaidi, S. Akbar, 'Tuberculosis in Pakistan: Social, Economic and Policy Concerns', in Meulemans, Herman (ed.), *Tuberculosis in Pakistan: The Forgotten Plague* (Leuven, Belgium: Acco, 2000).
45. World Bank, *Pakistan: Health Sector Strategy*, Report No 16695-PAK (Washington DC: World Bank, 1998), 23.
46. The reason why we look at the case of tuberculosis in some detail here, is because it is one of Pakistan's main diseases, afflicts a large number of people, is rather simple (and relatively inexpensive) to treat, and because a larger number of non-clinical socio-economic studies have been conducted on tuberculosis than on most other diseases in Pakistan. This section of the chapter is drawn from Zaidi, S. Akbar, 'Tuberculosis in Pakistan: Social, Economic and Policy Concerns', in Meulemans, Herman (ed), *Tuberculosis in Pakistan: The Forgotten Plague* (Leuven, Belgium: Acco, 2000).
47. These countries are Brazil, Indonesia, Iran, Mexico, Philippines, The Russian Federation, South Africa and Thailand.
48. These are Afghanistan, Ethiopia, India, Myanmar, Nigeria, Pakistan, Sudan and Nigeria. Of these eight low income countries, Pakistan is the richest in terms of per capita GDP.
49. These six are: Brazil, Ethiopia, India, Indonesia, Nigeria and Pakistan; Source: World Health Organization, Global Tuberculosis Programme, Internet Web Pages.
50. National HMIS Cell, Government of Pakistan, Ministry of Health, *Tuberculosis in Pakistan Assessed Through National HMIS* (Islamabad: October 2001), 4.
51. MHHDC, op. cit., 2005, 30.
52. See Zaidi, S. Akbar, op. cit., 2000, 66 passim. The Karachi Anti-TB Association had calculated the cost of medication per day to be Rs.15 and Rs.4,500 ($100) for the full course of treatment. All prices are FY 2000 prices.
53. While the rupee costs would have increased, it would still probably be approximately accurate to suggest a figure in the range of $90–100 for tuberculosis medication. However, the per case total budget available for the national tuberculosis programme in Pakistan is only US$27—see MHHDC, op cit., 2005, 30.
54. The reason why these costs are low and why there is so much variation at different tiers is because these costs were *actually incurred*. Hence, these costs would be registered even if treatment was given for a week rather than for the full nine month course of treatment for tuberculosis.
55. The Brenzel and Zaidi study included health system costs.
56. See Vikram Pathania et al. *TB Patients and Private for-profit HealthCare Providers in India*, Global TB Programme (Geneva: WHO, 1997).
57. Katherine Floyd et al. 'Comparison of Cost Effectiveness of Directly Observed Treatment (DOT) and Conventionally Delivered Treatment for Tuberculosis: Experience from Rural South Africa', *British Medical Journal*, vol. 315, no. 29, November 1997.

58. Saunderson, P. R., 'An Economic Evaluation of Alternative Programme Designs for Tuberculosis Control in Rural Uganda', *Social Science and Medicine*, vol. 40, no. 9, 1995.
59. Government of Pakistan, *Pakistan Economic Survey 2004–05* (Islamabad, 2005), 40.
60. See MHHDC, op. cit., 2005.
61. Ibid.
62. MHHDC, op. cit. 188–9.
63. Ibid. 189.
64. It is very likely that the authors of the MHHDC Report, *Human Development in South Asia 2004: The Health Challenge*, mean untrained, rather than 'traditional'—hakims, homeopaths, etc.—practitioners.
65. The rural total does not add up to 100; it is not clear where the missing numbers are.
66. Unless otherwise stated, much of this Section draws from the MHHDC Report, *Human Development in South Asia 2004: The Health Challenge*, op. cit., 2005. This Report has a detailed Chapter on Pakistan in which Government programmes are documented in detail.
67. See Ministry of Health, *National Health Policy 2001: The Way Forward—Agenda for Health Sector Reforms* (Islamabad, December 2001), and Ministry of Health, *Progress on Agenda for Health Sector Reforms* (Islamabad, May 2003).
68. MHHDC, op. cit., 173.
69. Ibid.
70. Ibid. 185.
71. Ibid.
72. Ibid. 186.
73. Government of Pakistan, *Annual Report of the Director General Health 2002–2003* (Islamabad: Ministry of Health, 2005).
74. Ibid. 9.
75. Ibid. 10.
76. MHHDC, op. cit., 111.
77. Ibid. 112.
78. Government of Pakistan, *Annual Report of the Director General Health 2002–2003* (Islamabad: Ministry of Health, 2005), 10.
79. Ibid., and MHHDC, op. cit., 187.
80. On Social Action Programme, see, Social Policy and Development Centre, *Review of the Social Action Programme: August 1997* (Karachi, 1997).
81. Appraisal Mission, *Aide Memoire: Second Social Action Program Project* (Islamabad, 11 October 1997), V-31.
82. Ibid. V-32.
83. See Zaidi, S Akbar, op. cit., 2000, and Government of Pakistan, *Annual Report of the Director General Health 2002–2003* (Islamabad: Ministry of Health, 2005).
84. Oxford Policy Management, *External Evaluation of the National Programme for Family Planning and Primary Health Care: Final Report* (Islamabad, 2002).
85. This section is based on documents of the World Health Organization (WHO) and in particular, WHO, *Macroeconomics and Health: Investing in Health for Economic Development* (Geneva: World Health Organization, 2001).
86. See: Zaidi, S Akbar, 'Pakistan's Economy After 9/11: Will the End be Different this Time Around?' *Occasional Paper No. 6* (Cambridge: Centre of South Asian Studies, University of Cambridge, 2004).
87. An uneducated person will still be able to get a job to move him out of poverty, but an ill person might not be able to overcome his debility to be in a position to acquire even subsistence level funds.

Part 8

Poverty and Inequality

Poverty still remains a highly controversial theme in Pakistan's economy. While we know that poverty exists in Pakistan, the highly politicized and silly secrecy about its extent and nature—the poverty numbers—makes it difficult to understand the magnitude of that poverty. Fortunately, some scholars have been able to move beyond the facile debate surrounding poverty in Pakistan, and have helped us understand how and why it persists. Rural poverty continues to dominate while urban poverty may have fallen over the last few years, and many scholars argue that unless wide-ranging agrarian reforms—including land reforms—are undertaken, poverty will remain a permanent problem in Pakistan.

Even if poverty falls, issues of regional and income inequality afflict many Pakistanis and have political causes as well as consequences. The absence of a well-functioning taxation system which taxes the large amounts of wealth and incomes of many Pakistanis, allows the rich to get richer, and for inequality to persist. Those with no or few assets and intermittent incomes will continue to be discriminated against in the absence of active social intervention and public policy. With development expenditure falling and with growth rates well below adequate levels, neither poverty nor inequality will be eliminated.

22 Poverty: Trends, Causes, and Solutions

Towards the middle and late 1980s, there was ample evidence available to confirm the perception that there was a continuous decline in poverty in Pakistan, for almost two decades, and at times quite dramatic a decline. However, early in 1990s, there were some concerns which suggested that perhaps that decline had slowed down, or had even been reversed. The question raised by researchers in the mid-1990s was whether poverty had returned to Pakistan, a question which was answered in the affirmative by the wide recognition and consensus, that poverty was on the increase, even though data was still lacking to make definite and precise claims.[1] Later, the availability of data and interpretations and analysis of macroeconomic trends substantiated those earlier claims. Based on those trends, since the end of the 1990s, there was ample evidence that poverty continued to persist in Pakistan, and in fact, worsened considerably since the mid-1980s. The question which was asked at that time was whether poverty had become a permanent feature of Pakistan's economic and social reality, notwithstanding attempts at poverty reduction. While these questions were being asked at the end of the 1990s, major developments took place in Pakistan's—and the region's—political economy, which had a profound effect on numerous factors, including poverty—see Chapters 18 and 25 for some of these developments. With regard to poverty, the government of President General Pervez Musharraf and Shaukat Aziz made the claim and presented ample sets of data, which showed that poverty had fallen sharply, throughout the decade of the 2000s, certainly up to 2007/8, and may be even after that. There has been a vibrant and polarized discussion about the poverty numbers from the last decade, an issue which is also discussed in this chapter.

This chapter, based on a review of trends regarding poverty incidence over the last five decades raises many issues on poverty in Pakistan. The emphasis will be on an examining the reasons why income and poverty fell in the 1970s and 1980s, and why it began to rise in the 1990s, as well as a review of the new debate in the 2000s. If we can explain and understand the reasons for these trends, it would be helpful in answering our question, i.e. is poverty a permanent phenomenon in Pakistan's economic and social life? At the outset, it is important to clarify the scope of this chapter and, more importantly, to emphasize the areas it does not cover. This chapter does not present a review of literature in the conventional sense, identifying previous studies which have looked at some of the many aspects of poverty in Pakistan, simply because there have been a number of excellent and detailed recent studies and reports which have done this.[2] Nor does the chapter make any comment on the methodology employed in estimating poverty lines and trends, and nor does it get into the process of estimating and presenting new numbers about poverty in Pakistan.[3]

What this chapter covers are the broad trends that have emerged in the incidence of poverty over the last fifty years, and attempting to explain these trends.[4] In particular, it looks in greater detail at the three or four years in the mid-1980s when poverty fell sharply and gives reasons for this reduction. This period is contrasted with that of the 1990s, when poverty rose almost as dramatically as it fell. This contrast and explanation helps in understanding whether poverty reduction in Pakistan took place under special conditions and whether those conditions are likely to be replicated, an issue which also emerges with regard to the special conditions after 9/11 when poverty fell—see Chapters 18 and 25. In addition, we discuss the current nature and causes of poverty in Pakistan, and a critical evaluation of government policies in redressing these poverty trends is also undertaken. Finally, in light of the causes by which poverty fell and the current efforts at poverty alleviation, we attempt an answer to the question: Can poverty in Pakistan ever be eliminated?

22.1 What Does Poverty Mean?

The Pakistan Human Condition Report prepared by the now defunct Centre for Research on Poverty Reduction and Income Distribution (CRPRID), a Planning Commission unit, brought out a highly depressing picture of the nature of poverty in the country, focusing on the condition of education, health and institutions. It showed that at least 6 million children between the ages of five to nine years were out of school; of the remaining 14 million children at that time, quality education was available to only a small minority; about 55 per cent of the 10+ year age population, was illiterate under a criterion of literacy which is not even basic under the UNESCO definition. Even with this sub-basic level of literacy, 80 million citizens were illiterate. If functional literacy were the criterion, then the illiterate population would be over 100 million. In addition, the participation rate at the university level was 3 per cent of the 17–23 year age group compared to East Asia and Organization for Economic Co-operation and Development (OECD) countries, where this rate was over 30 per cent. There was, and continues to be, a huge gender gap in this sub-basic literacy along with a rural-urban gap.

In Balochistan the female literacy rate at that time was 9 per cent, while in Punjab, Sindh, and NWFP the male literacy rate was around 72 per cent; the mortality rates for infants, children and mothers, was high by regional and world standards. Due to the very high maternal mortality rate of 400 per 100,000 live births, the sex ratio in Pakistan was 108 males to 100 females. For Balochistan, this ratio was 115 males to 100 females—see Chapters 19 and 20 for more recent numbers, as well as a discussion on the Millennium Development Goal targets.

These basic indicators, based on a very broad and general definition of poverty, would suggest that poverty was quite high in Pakistan at the end of the 1990s. This meaning of poverty can be further delineated by looking at some key deprivation statistics. For example, 45 per cent of Pakistan's population does not have access to adequate health care, while 40 per cent did not have adequate drinking water and 55 per cent were denied sanitation facilities. Seventy-five per cent of the female adult population was illiterate, and the under five mortality rate (a statistic which reveals a great deal about the quality of life) in Pakistan was the highest in South Asia, higher even than Bangladesh and Nepal.

Clearly, all standard indicators of social and economic exclusion and differentiation showed that poverty was quite severe in Pakistan. Yet such definitions were extremely insufficient to capture broader meanings of poverty, which should include issues of justice, rights, participation and equality, essentially all forms of social and economic exclusion, usually based on unequal material relations and their manifestation of inequitable power. While in this chapter we discuss largely issues related to economic and income poverty, the underlying themes of justice, equality and power have to be understood and recognized. Box 22.1 gives a brief definition of how poverty has been conceptualised in Pakistan.

Box 22.1

Defining and Measuring Poverty, Poverty Lines, and Calories

S. M. Naseem shows how the issue of measurement and the quantification of the poverty line has been central for researchers. Excerpts:

. . . A basic problem confronting all researchers is how to define poverty and whom to include in the category of the poor. Traditionally, poverty is defined in terms of some measure of monetary income considered adequate for subsistence. However, income in monetary terms may not be an adequate measurement of living conditions of poor populations. Besides the known problems with the measurement of household income, there is often a significant amount of non-monetary transactions, out-of-the-market transfers, access to public services, and production for self-consumption which may become more important than straightforward income, as measured in standard household surveys.

Until recently, much of the work on poverty measurement had been centred around the concept of income (or consumption) poverty. Admittedly, this is a rather narrow concept and does not capture the multi-dimensionality of the poverty syndrome. However, once one tries to move towards a more comprehensive treatment of poverty, both the conceptual and measurement problems become more formidable and the tension between satisfactory conceptualisation and accurate measurement tends to increase. (8)

. . . The most commonly used standard for the measurement of income or consumption related poverty, involves calculating a poverty line (based on some minimum acceptable level of consumption) and estimating the proportion of population below that line. Until 2001, when Pakistan's Planning Commission decided to establish an official poverty line (OPL), there was no uniform methodology for estimating this. The Planning Commission decided that the official poverty line for Pakistan will be estimated on 2350 calories per adult equivalent per day. This is based on an adult equivalent intake of 2150 calories in the urban areas and 2450 calories in the rural areas. The poverty line for Pakistan for FY1999 on this basis has been defined at Rs. 670 per capita per month. (11)

. . . Although the statistical base of most studies has been the Household Income and Expenditure Survey (HIES) data set—produced continually by the Federal Bureau of Statistics (FBS) since FY1964, and with greater frequency in the 1990s, the variations in the empirical results have stemmed from both differences in the methods of data processing and in the operational definition of poverty. With the adoption of the OPL, it was expected that controversies about poverty estimates, would tend to diminish. Unfortunately, this has not happened and the official estimates have been questioned, both from within the Government and outside. (12)

. . . The Planning Commission, after due deliberation and consultation, notified in 2002 the official poverty line (OPL), which was based on a threshold caloric intake requirement of 2350 calories per adult equivalent per day. This dietary intake requirement of 2350 calories translated through tthe Engel curve relationship into a poverty line of Rs. 673 per capita per month in 1998–99 prices and was to be updated by the CPI for the year in which the HIES/PSLM was conducted. This poverty line in caloric terms was broadly consistent with those used by earlier studies, although considerably higher than Naseem's (1973) and Ercelawn's (1988) in adult equivalent terms. (14–15)

. . . The main suspect of the Pakistan Poverty Puzzle is the elusive task of choosing an appropriate poverty line. Numerous attempts have been made to arrive at reasonable poverty lines for Pakistan. The two approaches used are the calorific approach and the basic needs approach.

The former gives primacy to the need for providing a diet fulfilling a specified calorific value considered necessary to survive while the latter explicitly recognizes the importance of a variety of other non-food needs such as housing, health, education, transportation, clothing and other needs. Although both the definitions have their advantages and downsides, the former is easier to calculate while the latter has the advantage of being more easily comprehensible. While it is possible to have a little less of housing, clothing, or transportation services, it is much more difficult to survive without food intake below the specified calorific requirements, even though the body could adapt reduced calorific intake in the short run—as marathon fasts-unto-death have shown. The two poverty lines generally do not differ a great deal in terms of monetary value at constant prices. For instance, a poverty line of 2100 calories per capita was valued at Rs. 31.4 per month in 1959–60 prices when inflated to reflect 1991–92 prices was valued at Rs. 15. (17–18)

Choice of Poverty Line

A crucial step in poverty measurement is the choice of a poverty line. A basic problem confronting all researchers is how to define poverty and whom to include in the category of poor. Traditionally, poverty defined in terms of some monetary measure of income considered adequate for persistence. In recent years, the World Bank has popularised the definition of poverty in terms of $1 per capita per day or in case of a more inclusive definition of poverty of $2 per capita per day. Inevitably this is a rather simplistic definition of poverty which ignores differences in nutritional requirements, housing standards, educational aspirations and other basic needs and rights of individuals.

In Pakistan, Naseem's definition of the rural poverty line at a per capita expenditure of Rs. 250 per year (58.5 paisas per day) at 1959–60 prices and for the urban poverty line at per capita expenditure of Rs. 300 per year or 82 paisa's per day at 1959–60 prices for rural areas and Rs. 375 per year at 1959–60 prices was generally accepted by later researchers. The rural poverty line was based on the Report on Agriculture Workers in Pakistan which considered Rs. 300 per capita per month to be not much above the subsistence level.

Naseem in his later study for ILO [Naseem (1977)] estimated the poverty line by using a calorie base approach to infer the consumption expenditure from a specified level of calorie intake. This was done by regressing the amount of calories per day on the amount of total expenditure per person. Other authors have preferred a more direct estimation of the poverty line based on the satisfaction of basic needs rather than on nutritional requirements alone. However, while it is true that nutritional needs are not the only one that are important in determining the household poverty status, it is difficult to refute that they are the most important human needs at least in a poor country like Pakistan. Even in the calories based approach, there is an implicit arbitrariness in increasing the level of calorie intake considered for survival. However, the long period of reduced calorie intake can cause incapability or functioning.

Recent controversies about the varying estimates of poverty based on different poverty lines have raised serious questions about the sanctimony, uniqueness or infallibility of the concept [Krishnaji (2012)]. The poverty line corresponding to an attainable minimal bundle of goods and services for a normative subsistence level is at best a loose concept and non-operational except in a very limited sense. Since the question, 'who (an expert group, a public statutory body or an international organization) is to set the norms and how it has to be done' (in terms of the disaggregation of commodities, regions and social groups) cannot be answered to the satisfaction of all, any poverty line referring to a minimal bundle has to be subjective and arbitrary. It is arbitrary, moreover, because in practice the normative minima are never clearly specified; indeed it is difficult to do so even if we restrict ourselves to, say, food, clothing, shelter and access to education and healthcare. Consequently, all procedures to derive a poverty line—however well-intentioned and assiduous—are inevitably arbitrary, based on questionable assumptions.

If the total household expenditure level at which a specified calorie intake norm is satisfied in per capita terms is chosen as a basis for setting the poverty line, it is assumed that at that level other minima are also attained so that households with expenditures below that level may be regarded as poor [Haq and Bhatti (2001)]. Other procedures relying wholly on expenditure data are equally artificial, bearing little relation to the different dimensions of poverty. Another element of arbitrariness arises when a base level poverty line is adjusted upwards to allow for increases in prices from year to year [Anwar (2006)]. It is not easy to construct price indices for different classes of consumers. Given the near impossibility of making operational the concept of a minimum subsistence level, it is no wonder that the constructed poverty lines are subject to much criticism. (21–23)

Source: Naseem, S. M., *A Review of Studies on Poverty in Pakistan: Origin, Evolution, Thematic Content and Future Directions*, History of PIDE Series-6 (Islamabad: Pakistan Institute of Development Economics, 2012).

22.2 Trends in Poverty

Most of the studies which estimate trends in poverty levels and poverty incidence in Pakistan, use a headcount measure under an arbitrarily defined poverty line. The poverty line itself is usually based upon the concept of consumption poverty, where a minimum daily recommended calorie allowance determines that poverty line.[5] While comparison between different sets of figures derived by different scholars is quite problematic, this has been the norm for most comparisons—see Appendix 22.1 on estimating poverty lines.[6] Table 22.1 presents a number of sets of estimates of the extent of poverty across time, estimated by different studies.

Table 22.1
Trends in Poverty

1A Proportion of Poor (Headcount %)

Year	Total	Rural	Urban
1963–64	40.24	38.94	44.53
1966–67	44.50	45.62	40.96
1969–70	46.53	49.11	38.76
1979	30.68	32.51	25.94
1984–85	24.47	25.87	21.17
1987–88	17.32	18.32	14.99
1990–91	22.11	23.59	18.64
1992–93	22.40	23.35	15.50
1996–97	31.00	32.00	27.00
1998–99	32.60	34.80	25.90

1B Incidence of Poverty (%)

Year	Total	Rural	Urban
1975	35.5	49.8	19.0
1980	27.7	36.2	11.8
1985	9.4	15.2	7.4
1990	12.4	19.0	4.8
1995	14.7	23.1	2.6

1C Proportion of Poor (Headcount %)

Year	Total	Rural	Urban
1984–85	46.0	49.3	38.2
1987–88	37.4	40.2	30.7
1990–91	34.0	36.9	28.0
1993–94	28.6	33.4	17.2
1998–99	32.6	35.9	24.2

1D Proportion of Poor (Headcount %)

Year	Total	Rural	Urban
1986–87	26.9	29.4	24.5
1987–88	26.4	29.9	22.7
1990–91	23.3	26.2	18.0
1992–93	20.3	22.5	16.8
1993–94	20.8	24.4	15.2

Source: 1A: Planning Commission, Government of Pakistan, *Human Development and Poverty Reduction Strategy*, (Islamabad, April 1999), and Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues). 1B: Social Policy and Development Centre, (Karachi: SPDC 1998); 1C: World Bank (Washington DC: WB, 2002); 1D: MHCHD/UNDP (Karachi: OUP, 1999).

The percentages presented in Table 22.1, and the numbers that they reveal, are critically important especially when the Government of Pakistan acknowledged the fact that in 2003/4, there were almost 50 million people (32 per cent of the population) or 7.5 million households that fell below the poverty line. After 2008 or so, there has been a huge controversy about the extent and proportion of the poor in Pakistan, and there is no agreed estimate—see Box 22.2. For the moment, however, let us examine the trends in poverty incidence rather than the scale and magnitude of the incidence of poverty in Pakistan.[7] The Table confirms the view that poverty first rose in the 1960s, after which it saw a continuous decline until around 1987/88, after which, for the most part, there was another rise in the incidence of poverty in the country. However, a study by Haris Gazdar, Stephen Howes and Salman Zaidi[8] (which was one of the Background Papers on which the influential World Bank Pakistan Poverty Assessment Report of 1995[9] was based), along with the MHCHD/UNDP study, showed that the declining trend in poverty was seen to continue, albeit at a slower pace, into the 1990s. Nevertheless, and problems of data and measurement notwithstanding, almost all of the then literature on poverty in Pakistan suggested that there was a growing 'consensus' that poverty had increased since the early, and most certainly, since the late, 1990s.[10] Moreover, despite different measurements and estimates, there was almost complete agreement on the impressive decline in poverty during the period 1969–70 to 1979, a drop of almost 16 percentage points over the decade, and an equally impressive fall of 13 percentage points in the next decade, until 1987/88. Moreover, in the 1980s, the period 1984/85 to 1987/88 showed a drop in poverty by more than 7 percentage points using Panel 1A from Table 22.1, and almost 9 points as seen in Panel 1C.

Another noticeable trend from Table 22.1 is the more or less consistent fall in urban poverty throughout the last fifty years. Although only 23 per cent of the population lived in cities in the early 1960s compared to more than sixty per cent today, this decline in urban poverty has continued even when there was a rise in rural poverty. However, the dramatic fall in poverty in the 1970s was attributed to the huge reductions in rural poverty which accounted for a much larger proportion of the population and of the poor. The data from Panel 1B, in fact, shows that poverty in urban areas in the mid-1990s, had virtually been eliminated.[11] Table 22.2 shows some of the earliest work on poverty estimates in Pakistan, starting with Professor S M Naseem's seminal work in 1977. Table 22.3 shows us a provincial distribution of poverty incidence in the 1990s, while Box 22.3 shows us that even within provinces, in this case the Punjab, there is a great deal of differentiation, an issue which is discussed further in Chapter 23.

If we examine trends in income distribution, we observe that during the 1960s when there was high growth and poverty increased, the Gini coefficient fell from 0.355 to 0.33 improving the distribution of income for both urban and rural areas—see Table 22.4.[12] In the 1970s, there was again an inverse relationship between poverty and income distribution, with the latter improving and the former worsening. Both the 1980s and the 1990s saw poverty and income distribution moving in the same direction, with poverty falling in the 1980s and income distribution improving; the decade of the 1990s had the opposite trends. Currently, income distribution based on the Gini coefficient was worse than what it was in the early 1960s.[13] Not only that, but the concentration of income has also worsened in recent years, with the income share of the highest twenty per cent increasing over time, with that of the lowest twenty per cent falling. Many people,

Box 22.2

Intrigue and Accusation: The Debate over Poverty Numbers during the Musharraf Years

S. M. Naseem writes about the allegations and disputes about poverty numbers in Pakistan in the 2000s and after. Excerpts:

Recently, in a déjà vu of earlier controversies, there has been a heated debate on the poverty estimates comparing the situation before and after the 2008 elections and the end of the Musharraf regime. The Planning Commission's estimates based on this methodology showed that poverty had increased from 30.6 per cent in 1998–99 to 32.1 per cent in 2000–01. The CRPRID re-estimated the poverty incidence for 2000–01 on the basis of a revised methodology as 34.6 per cent. Its estimates for 2004–05 showed that poverty incidence had declined to 23.9 per cent, indicating a ten percentage point reduction in poverty during the first five years of Musharraf regime. In order to confirm the rather sharp decline in the reported poverty figures, the Planning Commission hired the services of Professor Nanak Kakwani of Australia for a third party validation of the Centre's estimates. Professor Kakwani validated the estimates for 2000–01 and 2004–05 as well as the figures for 2005–06 which indicated a marginal decline to 22.3 per cent from 23.9 per cent in the previous year. The World Bank was also invited by the government to validate the estimates and in its May 2008 report, the Bank endorsed the CRPID/Planning Commission estimates. The CRPRID also estimated poverty incidence for 2007–08 using the HIES of that year and found that the number of people below the poverty line had declined by more than five percentage point to 7.2 per cent in 2007–08 compared to figures in 2005–06.

The figure of 17.2 per cent for 2007–08, the last year of the Musharraf regime also raised political eyebrows. The new civilian government, elected in February 2008, asked the World Bank to send their expert to validate the estimates of the Centre, as on the previous occasion. The World Bank team again endorsed the CRPRID estimates by replicating the results from raw data of PSLM 2007–08 which, surprisingly gave exactly the same poverty estimates (17.15 per cent for national, 10.1 per cent for urban and 20.6 per cent for rural areas) as the results from HIES.

By using the Pakistan Social and Living Standards Measurement Survey (PSLM) for the year 2007–08, CPRSPD estimated poverty for 2007–08. They found that the number of people living below the poverty line declined from 22.3 per cent in 2005–06 to 17.2 per cent in 2007–08. Both rural and urban poverty also registered declines from 27 per cent to 20.6 per cent and 13.1 per cent to 10.1 per cent, respectively during the period. These results were presented to the planning commission in March 2009—one year after the new government took charge of state of affairs, causing it some public relations unease in accepting that poverty had declined so rapidly during the Musharraf years.

The Planning Commission demurred at these results and asked for their validation by the World Bank. The World Bank assigned two experts, Nobu Yoshida and Tomayuki Sho, to undertake the validation exercise, who presented their findings to the Planning Commission on 29 May 2009, endorsing the CPRSPD estimates and recommending their official release by the Government. While the Government balked, World Bank released these poverty numbers through its report titled 'Partnership Strategy' [World Bank (2010)], dated 30 July 2010. The Report stated that 'Pakistan saw an impressive decline in poverty during 2001–02 to 2007–08; the share of the population living in poverty halved, down from 34.5 per cent in 2001–02 to 17.2 per cent in 2007–08. Both urban and rural areas saw significant reductions.' The Report attributed the decline in poverty to the 'growth in real per adult consumption expenditures and declining inequality during 2005–06–2007–08. Key human development indicators of educational attainment, health outcomes and unemployment rates corroborate these trends through 2007–08'.

In contrast, the Panel of Economists headed by Dr Hafiz A. Pasha, had found in April 2008 that 35 to 40 per cent of the population was living below the poverty line in 2007–08—up from 22.3 per cent in 2005–06. The estimates were based on preliminary data for 2007–08. . . .

. . . The absence of any firm survey data on consumption expenditures since 2008–09 has been a serious handicap for analysts of poverty in Pakistan, as well as for international organizations. To overcome this difficulty the HIES for the year 2010–11 was completed in 2011 and its results were finalised last year. The Government had not released the survey results till mid May 2012.

Source: Naseem, S. M., *A Review of Studies on Poverty in Pakistan: Origin, Evolution, Thematic Content and Future Directions*, History of PIDE Series-6 (Islamabad: Pakistan Institute of Development Economics, 2012), 15–17.

including economists, do not understand the relationship between poverty and income inequality and often confuse the two. Box 22.4 throws some light on the issues. In Chapter 23, we discuss further issues of income inequality in Pakistan.

In the decade of the 2000s, a major controversy emerged with regard to poverty levels in the country. As we show in Chapter 18 on the macroeconomics of the Musharraf period and after, growth rates for the period 2002–7, were particularly high and despite accusations of a false, bubble boom, per capita incomes rose considerably in this period. For many other reasons, such as higher remittances, the fiscal space created which allowed government to spend more, increasing private investment, even foreign aid which was distributed in Pakistan, it was probable that poverty fell in Pakistan. Anecdotes and professional reports by economists argued that the high growth was resulting in lowering growth, that the 'trickle down' phenomenon was at work. Nevertheless, the scale and extent of poverty reduction in Pakistan was aggressively contested and debated, to the extent, that since 2008, the government which came after the Musharraf-Shaukat Aziz one, has refused to publicly declare its own estimates of poverty In Pakistan in the absence of

Table 22.2
Survey of Poverty Estimates

		Poverty line	1963/4	1969/70	1971/2	1978/9	1984/5	1987/8
Naseem (1977)	(1959/60 Rs)/capita							
Rural		250	43	36	19	–	–	–
		300	61	60	58	–	–	–
Urban		300	55	35	25	–	–	–
		375	70	59	63	–	–	–
Alauddin (1975)	(1959/60 Rs)/capita							
Rural		250	57	36	42	–	–	–
		300	67	61	65	–	–	–
Urban		300	50	30	42	–	–	–
		375	71	60	62	–	–	–
Naseem (1977)	% of 2,100 cals RDA							
		95	72	68	74	–	–	–
		92	54	46	55	–	–	–
		90	45	36	43	–	–	–
Mujahid (1978)	% of 2,100 cals RDA							
Rural		250	27	35	–	–	–	–
		300	40	48	–	–	–	–
Urban		300	36	29	–	–	–	–
		375	52	46	–	–	–	–
Irfan and Amjad (1984)	(1979/80 Rs)/capita							
Rural		109	41	55	–	41	–	–
		95	32	43	–	29	–	–
Krujik and Leeuwen	(1978/80 Rs)/HH							
Rural		700	–	73	–	51	–	–
Urban		700	–	50	–	30	–	–
Malik (1988)	(1984/85 Rs)/capita							
Rural		159	37	44	–	29	24	–
		172	43	51	–	35	29	–
Urban		185	40	34	–	24	19	–
		207	49	43	–	31	26	–
Ahmed and Allison (1990)	(1979 Rs)/capita							
Rural		100	–	–	–	25	20	–
Urban		110	–	–	–	20	16	–
Malik (1991)	2,550 cals RDA							
Rural		–	–	–	–	–	21	16
Urban		–	–	–	–	–	11	7

Source: Kemal, A. R. and Moazam Mahmood, 'Poverty and Policy in Pakistan', in Banuri Tariq *(ed.), Just Adjustment: Protecting the Vulnerable and Promoting Growth* (Islamabad: UNICEF, 1992), 51.

alternative data our understanding is that poverty fell very significantly in the Musharraf period, although income distribution probably worsened. We concur with the World Bank's assessment, where it states that:

> Pakistan saw an impressive decline in poverty during 2001/02–2007/08: the share of the population living in poverty halved, down from 34.5 per cent in 2001/02 to 17.2 per cent in 2007/08. Both urban and rural areas saw significant reductions. This progress was made possible by growth in real per adult consumption expenditures and declining inequality during 2005/06–2007/08. Key human development indicators of educational attainment, health outcomes, and unemployment rates corroborate these trends through 2007/08.[14]

These findings suggest that in 2007/8, poverty in Pakistan may have been at its lowest ever, at 17.8 per cent, with urban poverty down to a mere 10 per cent of the population. Despite the absence of official data since 2008, it is also safe to speculate that poverty must have risen over the period 2008 to 2013. The reasons for this are numerous, and include the high and persistent inflation in Pakistan, particularly food and fuel inflation which reduced purchasing power, a marked slowing down in the economy for numerous reasons, the

Table 22.3
Poverty Trends by Province

Province	FY93	FY94	FY97	FY99	2011
Urban Areas	20.7	16.3	16.1	22.4	35.75
Punjab	22.0	18.1	16.9	25.5	35.30
Sindh	17.3	11.8	12.0	16.1	32.36
NWFP	25.3	26.9	27.2	29.2	48.90
Balochistan	31.8	16.8	23.0	24.3	48.00
Rural Areas	28.9	34.7	30.7	36.3	37.31
Punjab	26.5	33.9	28.3	36.0	34.86
Sindh	29.5	31.8	19.6	34.7	39.92
NWFP	37.0	40.0	43.4	44.9	40.23
Balochistan	28.1	37.9	42.5	22.5	44.95
Overall	26.6	29.3	26.3	32.2	36.79
Punjab	25.2	29.5	25.0	33.0	35.00
Sindh	24.1	22.6	15.7	26.6	36.27
NWFP	35.5	38.1	41.2	42.6	41.71
Balochistan	28.6	35.5	38.4	22.8	45.68

Source: Asian Development Bank, *Poverty in Pakistan: Causes and Institutional Responses* (Islamabad: ADB, July 2002, 12. For 2011: Jamal, Haroon, *Predicting Sub-national Poverty Incidence for Pakistan*, Research Report 85 (Karachi: SPDC, 2013).

consequences of the war on terrorism—see Chapter 25—and the floods in 2010 and 2011, resulting In lower agricultural output. However, to what extent poverty may have risen, is completely unknown. See also Appendix 22.2.

22.3 Who Are the Poor and Where Do They Live?

Some of the salient features of poverty in Pakistan can be summarized as follows:

1. Rural areas have an unambiguously higher rate of poverty than urban areas for a wide range of poverty lines as Table 22.1 shows. The incidence of rural poverty is highest among those who own no land and over 40 per cent of landless household are poor and together constituted 70 per cent of the rural poor.
2. As Table 22.3 shows, in 1999 rural NWFP had the highest head-count ratio (i.e. percentage of people considered poor) with 45 per cent.
3. North Punjab has a smaller incidence of poverty than Sindh, which is better off than southern Punjab—see Table 22.3 and Box 22.3.
4. Across the country as a whole, head-count ratios fell from 46 per cent in 1984/5, to 37.4 per cent in 1987/8, and to 34 per cent in 1990/1; between 1984/5 and 1987/8, the head-count ratio fell by 18.6 per cent, while it fell by 9.1 per cent between 1987/8 and 1990/1. After the end of the 1980s there had been a marked increase in poverty.
5. The gender structure of income is significantly linked to poverty, but household size and dependency ratios are not.
6. The poor had the lowest earners per household; female-headed households, or households reliant on women's income, were likely to fall into poverty. The poor have a much higher proportion of female-headed households;

Box 22.3

Regional Pattern of Poverty in the Punjab

There is considerable diversity in the level of poverty in the rural and urban areas within provinces as well, but only the sample for the Punjab is large enough to generate poverty estimates for regions within the province. Punjab has been divided into three regions: Northern Punjab (including Islamabad, Rawalpindi division, and the district of Mianwali), central Punjab (including Sargodha, Faisalabad, Gujranwala, and Lahore divisions) and southern Punjab (including Multan, Dera Ghazi Khan, and Bahawalpur divisions). There are substantial differences in poverty levels in the three regions. The incidence of poverty is consistently the lowest in northern Punjab and the highest in southern Punjab, both in the rural and urban areas. In FY1999, urban poverty was the highest in the country in southern Punjab (35 per cent), and almost three times more than in Northern Punjab. Urban areas in northern Punjab had the lowest level of poverty in the entire country, while rural northern Punjab had the lowest level of poverty (29 per cent) among the rural areas of the country. Poverty in rural southern Punjab (39 per cent) was not significantly lower than the NWFP, while rural central Punjab had the same level of poverty (35 per cent) as rural Sindh.

Important lessons can be drawn from this pattern. Northern Punjab, which has the lowest level of poverty in the country, is agriculturally a poor region with the lowest cultivated area per capita, and no irrigation. On the other hand, southern Punjab, despite its highest cultivated area per capita and 100 per cent irrigation, is one of the poorest regions in the country. One reason for this seemingly contradictory outcome is that rural areas in northern Punjab on the other hand, are closely integrated with their urban centres, and have strong linkages with the services sector. Also the people of the region have a long tradition of employment in the public sector, particularly in the armed forces, as well as in-country and overseas migration. In contrast southern Punjab is the least urbanized region in the province, and mobility of local people in search of jobs outside the region or overseas has traditionally also been limited. It appears that, even more than agriculture production, non-farm employment opportunities, urban-rural linkages, agrarian structure and labour mobility, in which literacy can play an important role, are amongst the key determinants of rural poverty in the country.

Table 22.4
Trends in the Gini Coefficient

Year	Total	Rural	Urban
1963/64	0.355	0.348	0.368
1966/67	0.351	0.314	0.388
1968/69	0.328	0.293	0.370
1969/70	0.330	0.295	0.361
1970/71	0.326	0.273	0.359
1971/72	0.344	0.309	0.381
1979	0.375	0.319	0.380
1984/85	0.428	0.345	0.379
1985/86	0.355	0.330	0.354
1986/87	0.346	0.312	0.357
1987/88	0.348	0.307	0.366
1990/91	0.407	0.410	0.390
1992/93	0.390	0.367	0.384
1993/94	0.400	0.40	0.350
1996/97	0.400	0.41	0.380
1998/99	0.410	0.40	0.330
2001/2	0.411	0.357	0.439
2004/5	0.407	0.347	0.428
2010/11	0.410	0.380	0.411

Source: MHCHD/UNDP, (Karachi: OUP, 1999, 85 for 1993/94, 1996/97 and 1998/99; Government of Pakistan, *Pakistan Economic Survey 2002–03*, (Islamabad, 2003), 50. For 2001/2, 2004/5, 2010/11, see Jamal Haroon, *Pakistan Poverty Statistics*, Research Report No. 84, SPDC, Karachi, 2012.

this poverty is due to gender discrimination, the male-female income ratio being 17 in rural areas and 16 per cent in urban areas.

7. In the rural areas, the poor are predominantly share-croppers. They own the least land, are the smallest landlords, and have not shifted to modern forms of lease contracting. The lack of asset ownership is both a *cause* of poverty—since assets generate income—as well as a *consequence* of it—because ownership is the result of past investment. *Rural poverty has a very strong link with unequal land ownership and the lack of access to land.*
8. In the urban areas, the poor have a low share of income from manufacturing, and earn most of their income from construction, or in the services sector.
9. The poor earned only 29 per cent of their income from wage employment, compared to 38 and 32 per cent for the middle and upper income groups; the poor were also more dependent on gifts and remittances, making them more dependent on others.
10. The rural poor spent 80 per cent of their budgets on the four essentials—food, rent, energy and apparel—while the middle and upper income groups spent 74 and 66 per cent, respectively. Likewise, in urban areas, the poor spent 82 per cent on these items, compared to 76 per cent by the middle income group and 70 per cent by the upper income group. Both in relative and certainly in absolute terms, the poor have less to spend on other commodities, which include essentials like health and education.

Box 22.4

Are Poverty and Inequality the Same Thing?

Many people, even academics, believe that if there is poverty in a country, it follows that there is inequality as well. There is an assumption made by them which equates both. This is incorrect as poverty and inequality are two distinct concepts. There can be a great deal of wealth in one country with little poverty, yet a great deal of inequality. Saudi Arabia is one example of this. Similarly, countries which are very poor in income terms at least, can be less inequitable and more equal than rich countries. Some of the earlier socialist states, such as Cuba, come to mind. Andre Beteille, one of India's leading sociologists sheds some light on this issue below.

"Those interested in social theory rather than social policy recognize that the relationship between poverty and inequality is neither clear nor direct. Poverty and inequality are analytically distinct concepts. They vary independently of each other; and it is misleading beyond a point to treat the one as a marker of the other. It is no argument to say that where there is a high incidence of poverty inequality is generally widespread, for contrary examples may also be found. The study of both poverty and inequality has been closely associated with an interest in economic and social change. But poverty and inequality do not change at the same pace, and they may even change in opposite directions.

A decrease in poverty is not always accompanied by a decrease in inequality; it may in fact be accompanied by an increase in it. Conversely, an increase in poverty may be accompanied by a decrease in inequality overall, although examples of this may be difficult to find in the contemporary world. The aim of policymakers concerned with social welfare has in general been to bring about simultaneously a reduction in both poverty and inequality, although this has proved difficult to accomplish.

The divergence of views regarding the relationship between poverty and inequality is largely due to the fact that there are different conceptions of poverty and different kinds of inequality. There is a relative and an absolute concept of poverty, and that there are many kinds of inequality besides those of income and expenditure. Those who use an absolute concept of poverty find it easier to delink poverty and inequality, particularly when their concern is mainly with inequalities of income and expenditure. On the other hand, those who adopt a relative concept of poverty tend to argue that there is a close if not inextricable relationship between inequality and poverty.

Source: Beteille, Andre, 'Poverty and Inequality', *Economic and Political Weekly*, vol. 38, no. 42, 2003, 4456.

One reason why there are regional variations in poverty is that poverty depends greatly on natural and infrastructure endowments, on the distribution of resources within a region, and on the structure of the economy. Institutional structures and arrangements, and regional policy variables, both in the private sector and due to public policy, also influence poverty. Issues specific to regional poverty are discussed in Chapter 23.

22.4 Explaining the Trends in Poverty 1960–88

In much of the literature that has examined poverty trends in Pakistan, a key concern has been the relationship between economic growth and poverty. Although most authors have argued and cautioned that there are no hard and fast rules which reveal an automatic, strong, correlation, poverty is seen to be closely linked to, if not determined by, economic growth. In fact, *economic growth is considered to be an essential prerequisite for poverty reduction*. Almost every study examining the relationship of economic growth on poverty alleviation has argued that 'economic growth is the foundation on which poverty reduction can be achieved',[15] and that 'economic growth plays a dominant role in poverty alleviation and without strong and sustained economic growth poverty alleviation is not possible'.[16] A broad trend in the incidence of poverty can be gauged from Table 22.5 below, where trends in economic growth and poverty are presented over the last six decades. The table suggests, perhaps, that for the 1960s and 1970s, growth and poverty did not seem to have the 'correct' relationship, and only in the 1980s and 1990s, did both move in the right, inverse, direction. In the decade of the 2000s, this trend re-emerged, where high growth and falling poverty, were in sync. This important theme is developed later in this chapter, where the focus shifts from merely looking at growth, to emphasizing the context, nature and impact of that growth.

Although urban poverty declined in the 1960s, it was a considerable rise in rural poverty which resulted in an overall increase in poverty during Pakistan's Development Decade. In one of the very few papers that explain and analyse (rather than merely document) poverty in the 1960s, M. Irfan and Rashid Amjad,[17] provide an explanation for the rise in rural poverty. The main argument raised by the authors, is that the reason for high levels for poverty in the 1960s well into the 1970s were to be found in the significant changes in the agrarian structure, especially the size distribution of landholdings which were said to have had important repercussions for the rural occupational distribution of households. New technology was a key factor, which allowed large landowners to resume land previously rented-out for self cultivation. Tenant farmers were hence evicted, and had either to operate smaller landholdings, or then join the ranks of the landless labourers. Although there was greater agricultural growth on account of technological innovation, at the same time, the conditions of those evicted did probably deteriorate. Increased mechanization led to a decrease in demand for labour which may have been one of the key reasons for the increase in poverty despite high growth in output.

Growth rates for GDP, agriculture and manufacturing in the 1960s, were two or three times greater than those of the 1950s, and substantial structural changes were made in the economy in this decade. A GDP growth rate of almost 7 per cent for a decade and nearly ten per cent for manufacturing (Table 22.6), were probably responsible for the fall in urban poverty during the 1960s. The mode of production and relations of production were dramatically transformed in this decade, and although there was a substantial increase in agricultural growth, it was the manufacturing sector that was responsible for the high growth rates in the economy and for the lowering of urban poverty.[18]

While growth, particularly in the manufacturing sector, may have been the main cause for the reduction in poverty in urban areas in the 1960s, the reasons for the fall in poverty in the 1970s are less directly related with growth, and hence are far more interesting and instructive, particularly when we later consider the more recent trends in poverty and their explanations. The 1970s, due mainly to political factors, were the only years in the history of Pakistan, when the issues of poverty and economic equality were prominent.[19]

Table 22.5
Trends in Growth, Poverty, and Income Distribution

Decade	Growth	Poverty	Income Distribution (Gini)
1950s	Stagnated	Persisted	Unknown
1960s	Rapid Increase	Increased	Improved
1970s	Slow, Stagnated	Declined	Worsened
1980s	Rapid Increase	Declined	Rapid deterioration, followed by rapid improvement
1990s	Substantial Decline	Increased Considerably	Worsened
2000–07	Rapid Increase	Declined	Probably Worsened
2008–13	Substantial Decline	May have Increased	Unknown

Table 22.6
Decade Wise Growth Rates (%)

Decade	GDP	Agriculture	Manufacturing
1950s	3.1	1.6	8.8
1960s	6.8	5.1	9.9
1970s	4.8	2.4	5.5
1980s	6.5	5.4	8.2
1990s	4.6	4.4	5.8
2000s	3.6	0.4	7.0

Source: Government of Pakistan, *Pakistan Economic Survey* (Islamabad: various issues).

The much derided nationalization programme of the PPP government of 1972–77, may have been a key factor that provided and ensured employment guarantees to a vocal, predominantly urban, population. Public sector employment 'soared',[20] and the share of the social sectors in development plans increased substantially. In fact, when the PPP government was removed in 1977, development expenditure in 1976/7 was an extraordinary 11 per cent of GDP, the highest ever in Pakistan's 65 year history.[21] Because of its political orientation, a number of important changes were enforced in the economic and social structure in Pakistan during the 1972–77 period, many having a positive impact on poverty reduction, but perhaps not an immediate impact on economic growth.[22]

A number of policies which may have had an impact on poverty reducing measures included land reforms implemented in 1972; the nationalization of banks which resulted in a growth of the number of branches by 45 per cent in five years, resulting in an eleven-fold expansion in credit to agriculture, with the network reaching even far flung remote rural areas; as Parvez Tahir writes, 'for the first time, credit was also directed towards small farmers, businesses and industries and low-cost housing through mandatory targets for the banks'.[23] Self-employment and the small-scale sector were also encouraged by direct credit to small businesses and industries by the nationalized commercial banks and by the overall economic and political environment which favoured the small-scale industrial and services sector at the expense of the large-scale industrial sector. Urban employment also increased 'significantly' due to the booming construction sector as many ambitious public sector programmes were initiated;[24] urban wages also rose sharply in the mid-1970s.

While many of these programmes and initiatives may have had employment enhancing and poverty reducing consequences, an additional factor which was to change the face of Pakistan's economic and social structure, particularly in the 1980s, had its origins in the mid-1970s, and was to have a significant impact on poverty reduction from 1975 onwards up to the end of the 1980s, and again in the 2000s. This was the process of migration to the Middle East and the beginning of the remittance economy. During the 1972–77 period alone, as many as 100,000 workers left Pakistan to work overseas, sending in $1.4 billion in this period, a sum greater than the oil import bill for the country (even after the OPEC price rise) in the same period.[25] In the period 1977–80, an additional $4.2 billion had been remitted to Pakistan from the Middle East.

This process which began in the 1970s, was to become the single biggest factor which resulted in the high growth rates for the economy and, simultaneously, for poverty reduction, in the decade of the 1980s[26] (see Table 22.6). A great deal has been written on the Middle East phenomenon and its impacts,[27] and in this section we look mainly at the broader economic growth and poverty reducing mechanism, with far more detail at the nature of that growth and on poverty on account of remittances from the Middle East, in a later section. Moreover, since there are a large number of studies which look at trends in poverty in the 1980s and offer some explanations for the reasons in its decline,[28] we present the more important arguments in a somewhat summarized form below.

The high growth rates of the 1960s were repeated in the 1980s (Table 22.6), with the manufacturing sector leading overall economic growth, just as it did in the 1960s. It was primarily these high growth rates in the economy which were responsible for the fall in poverty for much of this decade. Income per capita in the 1980s rose by 3.2 per cent a year, compared to the 3.9 per cent rise recorded in the 1960s. Development expenditure continued to be high for most of the 1980s, as did spending on the social sectors, especially in the period 1984–85 to 1987–88, when poverty fell markedly (see Table 22.1)—this period is dealt with separately below because of the large reduction in poverty—see Table 22.7 and Chart 22.3 for trends in development expenditure. The trend of increasing public sector employment begun in the 1970s, continued well into the decade of the eighties; urban and rural wages also showed signs of an increase in this period. Probably the most important contributor to growth and to poverty reduction in this period, was the amount of money remitted from the Middle East. In the decade of the 1980s, as much as $23.1 billion were remitted to Pakistan, equivalent to almost 10 per cent of GDP in 1982/3—see the implications of this in another section below.

Although the discussion above presents some of the more general arguments which help explain the fall in poverty in the 1980s, it would be useful to look at some more detail at the period 1984/5 to the end of the 1980s when, perhaps, poverty fell the fastest in such a short period. There are many specific causes for this reduction which throw light on issues related to poverty reduction today.

While remittances from the Middle East continued to play a critical role in terms of economic growth and poverty alleviation between 1984/5 and 1990, a number of other important indicators and trends in this short period stand out: public expenditure in this period was above 26 per cent of GDP in three of the four years, and was 26.7 per cent of GDP in 1987/8, 'the highest ever in the country's history';[29] the overall government deficit was on average 8.2 per cent of GDP, higher than the annual average of 7 per cent for the entire 1980s—see Table 22.7 and Chart 22.3.

A key component of the development strategy in this period was the Junejo government's Five Point Programme, launched in 1985/6, which had a high rural component. The Programme focused on education, health, roads,

Table 22.7
GDP Growth, Developments, Defence, Debt, and Interest Payments 1961–2011 (% of GDP)

Year	Development	Defence	Interest Payments	Budget Deficit	GDP Growth
		as a % of GDP			%
1961/2	10.7	5.7	1.1	9.0	6.0
1962/3	11.9	4.6	1.2	10.7	7.2
1963/4	11.8	5.0	1.3	9.7	6.5
1964/5	10.0	4.3	1.6	7.9	9.4
1965/6	9.1	9.7	0.2	12.2	7.6
1966/7	15.1	6.9	1.6	13.2	3.1
1967/8	12.7	6.0	1.7	11.0	6.8
1968/9	12.0	6.3	2.0	10.2	6.5
1969/70	12.3	6.3	2.1	12.3	9.8
1970/1	9.9	7.1	2.0	11.3	1.2
1971/2	4.4	7.4	2.9	10.7	2.3
1972/3	6.4	7.1	2.1	9.4	6.8
1973/4	6.8	6.0	2.5	9.0	7.5
1974/5	9.5	6.6	2.2	14.3	3.9
1975/6	10.5	6.7	2.5	14.7	3.3
1976/7	11.2	5.9	2.7	12.4	2.8
1977/8	10.5	5.8	2.4	11.0	7.7
1978/9	9.8	5.7	3.5	11.9	5.5
1979/80	10.3	6.0	2.3	7.6	7.3
1980/1	9.4	6.2	2.4	7.0	6.4
1981/2	9.1	6.4	2.6	6.9	7.6
1982/3	8.9	7.1	3.4	8.5	6.8
1983/4	7.5	7.2	3.7	7.4	4.0
1984/5	7.8	7.5	3.8	9.3	8.7
1985/6	8.5	7.6	4.1	9.6	6.4
1986/7	7.0	8.0	4.5	9.4	5.8
1987/8	7.8	7.8	5.3	10.5	6.4
1988/9	7.0	7.5	5.3	9.1	4.8
1989/90	7.2	8.1	6.1	9.2	4.6
1990/1	7.0	7.0	5.9	7.4	5.6
1991/2	8.5	6.0	5.6	8.4	7.7
1992/3	6.4	6.4	6.3	9.0	2.3
1993/4	5.1	6.2	6.2	6.6	4.5
1994/5	4.9	5.5	5.6	6.3	4.1
1995/6	4.9	5.4	6.6	7.1	6.6
1996/7	3.8	5.4	6.9	7.0	1.7
1997/8	3.5	5.1	7.5	6.2	3.5
1998/9	3.6	5.2	7.8	6.5	4.2
1999/00	2.7	4.2	6.9	5.5	3.9
2000/1	2.3	3.3	6.0	4.2	2.0
2001/2	3.0	3.6	5.9	4.9	3.1
2002/3	2.8	3.5	4.6	3.9	4.7
2003/4	3.1	3.5	3.9	2.8	7.5
2004/5	3.7	3.5	3.4	3.5	9.0
2005/6	5.1	3.4	3.3	4.5	5.8
2006/7	5.3	3.0	4.5	6.1	6.8
2007/8	4.6	2.8	4.9	7.8	3.7
2008/9	4.0	2.7	5.3	5.6	1.7
2009/10	3.7	2.7	4.6	6.6	3.1
2010/11	3.0	2.6	4.2	6.5	3.0

Note: *General Pervez Musharraf's government carried out an accounting sleight-of-hand when it presented its first budget by showing that it had *reduced* Defence Expenditure. The usual previous practice was that military pensions were part of the Defence budget; however, this year this item was removed and placed under 'General Administration' thus reducing the Defence budget. However, if one compares like with like and we include military pensions for this year, there was actually an *increase* of eleven percent over the previous year's budget. In the years after 2000, military pensions are no longer included as part of the Defence budget.

Source: *Pakistan Economic Survey* (Islamabad: various years).

Chart 22.1: Poverty Trends

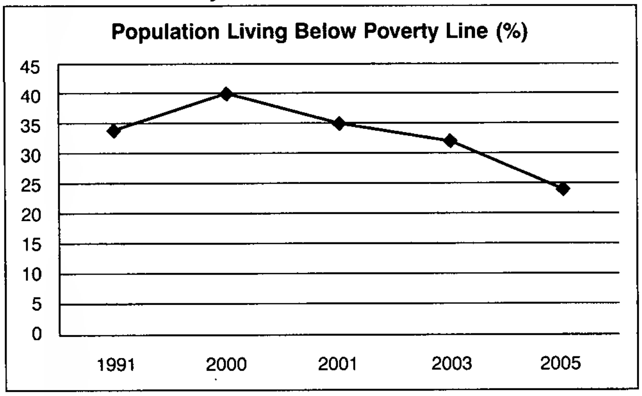


Chart 22.2: Trends in Income Inequality

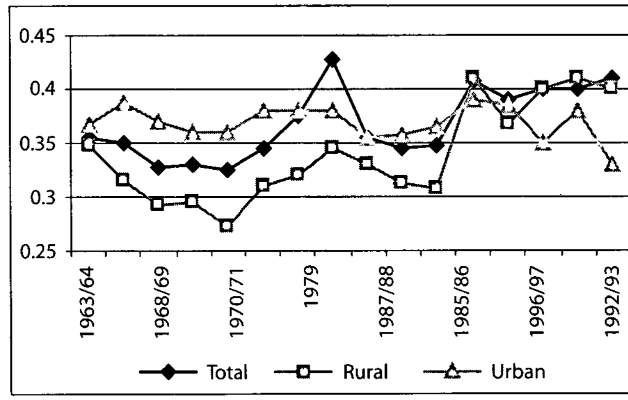
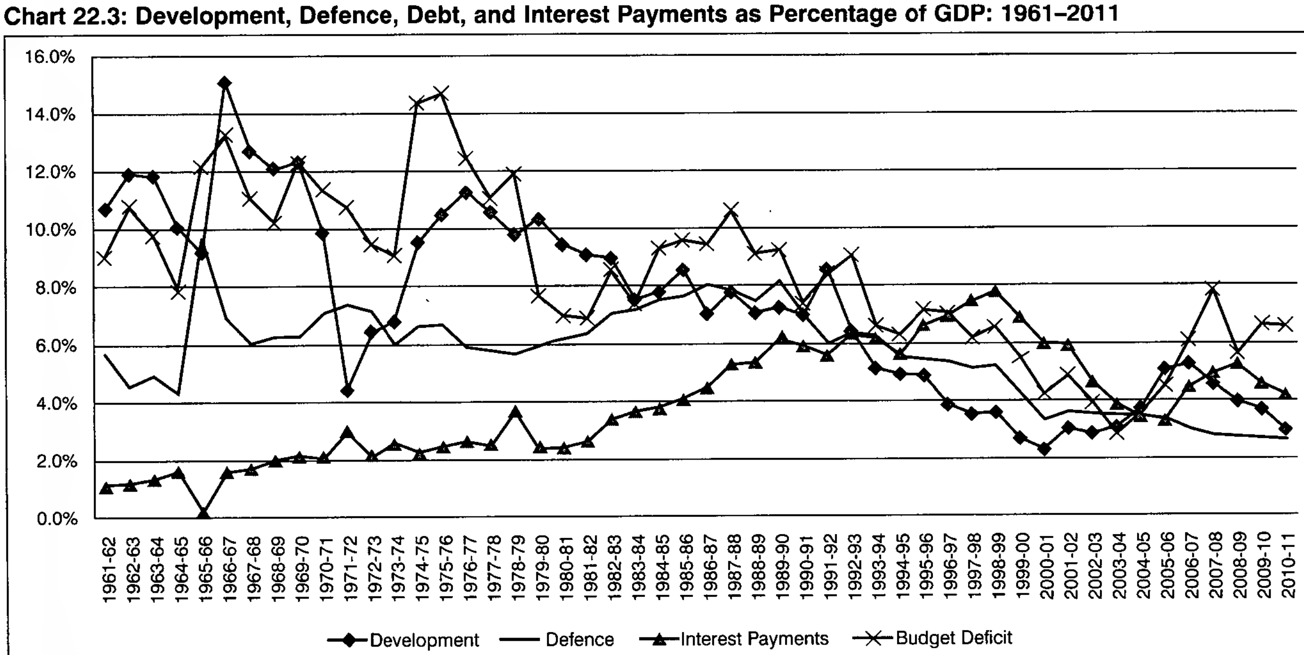


Chart 22.3: Development, Defence, Debt, and Interest Payments as Percentage of GDP: 1961–2011



electrification, water supply and sanitation, seven *marla* plot schemes for rural housing, all with a primarily rural focus. In addition, there was the Special Development Programme for local development, education and housing, along with the Senators' and MNAs' (Member of the National Assembly) Programmes, where elected representatives were allotted large amounts of money to spend on development projects in their constituency. Expenditure by government on health (as a percentage of GDP) in this period was higher than the average 0.7 per cent for the 1980s, rising to 1 per cent of GDP in 1987/8, amongst the highest allocations ever; similarly, expenditure on education in this period rose to an average of 2.3 per cent of GDP, higher than the 1.9 per cent average for the 1980s. The overall financial allocations for the Five Point Programme exceeded the Plan allocations by 18 per cent. There was a significant shift in resources 'towards rural areas as rural development utilized 48 per cent of the actual expenditure compared to the 32 per cent allocated originally in the Plan'.[30] Moreover, this accelerated spending on rural infrastructure is said to have promoted employment and income opportunities for the rural poor, while some urban schemes offered opportunities for the urban poor and unemployed.[31]

Moreover, even growth showed above average trends, with 6.8 per cent growth in GDP in this period, compared to the 6.45 average for the entire decade; with a bumper cotton crop of 8.6 million bales, growth in 1987/8 was led by an impressive 10 per cent growth in the manufacturing sector. Along with impressive rates of growth and poverty reduction, this period also probably saw the largest falls in the Gini coefficient suggesting that income inequality also improved; the Gini coefficient fell from 0.428 in 1984/5 (probably the highest ever), to 0.348 in 1987/8. Interestingly, the Five Point Programme was terminated with the dismissal of the Junejo government towards the end of the fiscal year 1987/8, in May 1988. Perhaps the culmination of this Programme helps explain the trends observed in the incidence of poverty after 1988, as shown in Table 22.1.

22.5 Poverty in Pakistan: 1988–2013[32]

The factors which led to poverty reduction in the eighties were, primarily, *high growth rates helped by very significant remittances, and an active and spendthrift public sector*. Let us examine the trends in these and other key influences on poverty towards the end of the 1980s.

Just as the declining trends in poverty at the end of the 1980s coincide with the end of the Five Point Programme, they also, equally coincidentally, begin a slowing down or reversal, at the start of a comprehensive IMF funded Structural Adjustment Programme initiated in the fiscal year 1988/9, in December 1988. Although there has been criticism on the rationale for Pakistan undergoing such a programme when it did, it is important to describe the nature and contents of such programmes.[33]

One of the criticisms that has been directed against the IMF and the World Bank sponsored Structural Adjustment Programmes, is that these programmes are usually too uniform in nature and are implemented universally across countries, without taking due cognizance of particular histories, institutions, and structures, and that these programmes lack context. A very general economic restructuring programme designed for any or all countries in need of restructuring has, at best, a few minor specificities which are spelt out in the details of the programme for each country. Usually, these are a few specific targets or a set of numbers to be achieved by the end of the programme period, and differentiate one country's programme from that of another.

Structural Adjustment Programmes are meant for economies in 'distress', often on the 'brink of disaster', having usually, though not exclusively, balance of payments problems. The aim of the Structural Adjustment Programme is to reduce the current account deficit, to lower inflation, increase the growth rate in the economy and to cut the fiscal deficit. The mechanism to achieve these goals is, by now, fairly well known and standard. Countries are expected to remove non-tariff barriers, replacing them with tariffs, tariffs which are supposed to be lowered substantially across the adjustment period, so that cross-border 'distortions' are removed by getting 'prices right'. On trade, in addition to large reductions in tariffs, countries are expected to devalue their currencies so that domestic currencies better reflect the true price of foreign currencies, where their demand and supply, rather than government intervention, determine that price. Greater liberalization and openness, with more focus on exports, rather than on import substitution, form the key ingredients of what goes for the trade sector 'reform' under the Structural Adjustment Programme.

Often the fiscal deficit is considered to be the mother of all evils, and the most significant and real cause of the distortions and problems that exist in the economy. In fact, all the problems which determine the need for a Structural Adjustment Programme, such as, high inflation, low growth, a high current account deficit, lower private sector investment, crowding out and sundry problems are (incorrectly) attributed to a high, 'unsustainable' fiscal deficit. Hence, a cut in the fiscal deficit is probably the most important component of the Structural Adjustment Programme. The World Bank and the IMF advise countries undergoing adjustment to rationalize their tax structure, to impose a consumption oriented general sales or value-added tax, to impose taxes on sectors of the economy currently exempted, and to remove all special privileges given to sectors of the economy in order to encourage certain industries or sectors. On the expenditure side, a cut in government expenditure is critical in order to reduce the fiscal deficit, where privatization is promoted so that the loss-making government departments and institutions can be handed over to the private sector. While the emphasis in cutting government expenditure is usually on consumption expenditure, frequently countries are asked to cut overall spending which includes capital and development expenditure. By hoping to raise revenue by imposing more taxes, and by cutting 'wasteful' government expenditure, countries are expected to reduce their fiscal deficit to more 'sustainable' levels. The removal of subsidies which, in most underdeveloped countries are on food items, essential inputs like fertilizer, or on utilities, is also an important plank of the policy directed to reduce the fiscal deficit.

Regardless of the causes for inflation, monetary 'discipline', in the form of limiting monetary expansion to some preconceived quantum, is supposed to be part of the adjustment programme. The interest rate, at the same time, is supposed to be determined by the supply and demand for credit and money, i.e. by the market. Government intervention to determine the interest rate or to provide directed credit to key sectors and industries at subsidized rates, is actively discouraged. Financial liberalization, with less government control over the banking sector, with far more competition, is expected by countries following agreements over the adjustment programme. Also, the preferential financial treatment to state owned enterprises is to be eliminated, so that these enterprises become more responsive to market signals.

In essence then, the Structural Adjustment Programme is supposed to be more market friendly, it is expected to promote private sector initiatives and interests, remove distortions in the economy by getting domestic and cross-border prices right, and to open up the economy to foreign goods and competition from abroad as the process of globalization proceeds. In addition, privatization should form an important component of the programme, and the role and involvement of the government in the economy and other sectors, should be minimized. The government's role should become one of an 'enabler', rather than an implementer, as defined by this philosophy.

Having followed at four Structural Adjustment Programmes (of the Extended Structural Adjustment Facility—ESAF—variety) and numerous smaller programmes starting in 1988 and between 2004 when the economy improved after 9/11, it would be important to examine some of the measures taken by the different governments in power in Pakistan since 1988, and determine the consequences on key variables affecting poverty—see also Box 22.5.

Box 22.5

The IMF, Structural Adjustment, and Poverty in Pakistan

In his extensive review of poverty studies, S. M. Naseem examines the impact of IMF policies on poverty in Pakistan. These policies have all resulted in increased poverty in Pakistan.

In Pakistan, the structural adjustment and stabilization programmes called for a reduction in fiscal deficit, a severe restriction on the role of government, rationalization of tax structure, removal of subsidies from consumption and production. These programmes however, had significantly adverse implications for employment, poverty and the government. A pioneering paper on this issue was that of A. R. Kemal. Kemal (1994) analysed the effects of Structural Adjustment Programme on the reduction of development expenditures and the trends in income distribution and poverty. Kemal concluded that although tariff rationalization, import liberalization, and certain other measures to promote efficiency were effective. However, the stabilization effort did not achieve much success. He found no positive correlation between fiscal deficit and inflation rate. Despite containing the government costs by wage restrictions and contraction of employment, non-development expenditure and fiscal deficit continued to increase. The employment situation further worsened due to privatization.

On the other hand, the Structural Adjustment Programme was accompanied by rising inequality and poverty. "The Gini coefficient increased from 0.34 to 0.41 and the incidence of poverty increased from 13 per cent in 1987–88 to 14 per cent in 1990–91" according to Kemal's findings. Among the reasons was the rising income inequality, decline in employment, the rise in the tax incidence of the poor relative to the rich and the adverse effect of the withdrawal of input subsidies on the poor while the increase in support prices of agricultural goods benefitted mainly to rich surplus farmers while hurting the small farmer and the alike. In conclusion, Kemal argued that structural adjustment programmes must be accompanied with targeted welfare programmes. Another significant article on Structural Adjustment is that of Talat Anwar. Anwar (1996) analyses Pakistan's growth performance in the late 1980s in the context of a medium term structural adjustment programme within the framework of the IMF and the World Bank signed in 1988. After examining the contractionary characteristics of the IMF and the World Bank structural adjustment model, the author examines the macroeconomic performance of the adjustment programme in Pakistan. Drawing upon the research of Faiz Bilquees (1992) (also quoted by Kemal in the preceding article) the author showed that poverty declined from 32 per cent in 1987–88 to 30 per cent in 1990–91. The contraction of employment in public sector had adverse effect on the labour market, pushing the real wages in agriculture and manufacturing sector in the first year of adjustment leading to deterioration in the living conditions of the poor. A combined effect of the public expenditure reduction and trade liberalisation resulted in almost doubling the urban unemployment rate from 4.58 per cent in 1987–88 to 8.19 per cent in 1990–91. In terms of poverty, the author's calculation on the incidence of poverty between 1987–88 and 1990–91 increased from 13.81 per cent to 17.26 per cent. Anwar, like Kemal, emphasizes the need for targeted subsidies to help the poor to overcome the adverse effects of structural adjustment programme.

Another significant paper analysing the structural adjustment programme during the period 1987–99 is that of Jamal (2003). The years chosen by the author for comparing the effects of structural adjustment programme are 1987–88 to 1998–99. The former year being the beginning of the structural adjustment Programme and the latter being the year for which HIES results are available. The paper shows that in terms of the macroeconomic stabilization indicators, the structural adjustment programme fails to achieve the major objectives.

With the exception of the share of domestic saving and of private investment in the GDP, and the growth of total debt services, other macroeconomic performance indicators did not show a significant improvement. On average, GDP growth feel by approximately two percentage point primarily due to fall in manufacturing growth from 9 per cent in the 1980s to 5 per cent in the 1990s.

In terms of distributional measures, the Gini-coefficient for Pakistan rose from 0.34 in 1987–88 to 0.38 in 1988–89 while the urban Gini-coefficient rose from 0.39 to 0.42 during the same period. A more glaring comparison between the share of the lowest quintile which was about 9 per cent in fiscal 1998 compared to 44 per cent for the highest quintile. However, by 1988, the share of the lowest quintile has declined to 8 and that of the highest quintile rose to 47 per cent. The situation in the urban areas was more pronounced than that in the rural areas.

The poverty numbers presented in the paper show that the head count ratio rose from about 24 per cent in 1987–88 to 30 per cent in the year 1998–99. Two other indicators of poverty also show that the 'adjustment decade' (also termed as the 'lost decade') was much harsher on the poor. The first indicator is the rise of the proportion of food in total consumption in the lowest quintile of population which rose from 41 per cent in 1987 to 45 per cent in 1999 or by about 4 per cent. However, the rise in shares of expenditure on health and education were 63 per cent and 186 per cent respectively—reflecting the increase in the component of private expenditures on these services. The components of consumption expenditure whose proportion has suffered heavy decline are durables, transportation, items for household and personal care and clothing.

Source: Naseem, S. M., *A Review of Studies on Poverty in Pakistan: Origin, Evolution, Thematic Content and Future Directions*, History of PIDE Series-6 (Islamabad: Pakistan Institute of Development Economics, 2012), 31–4.

Although it is difficult to prove causality, some interesting observations on the economy between 1988 and 2004 help show how the economy performed after the initiation of the Structural Adjustment Programme. Firstly, the overall growth rate of GDP fell well below trend levels, and appreciably below the average of the 1980s—see Table 22.6. In the sixteen years after the implementation of the programme, in only two of those sixteen years was growth in GDP more than the average six per cent observed since 1977; in two of those sixteen years, in 1992/3 and in 1996/7, the growth in GDP was 2.1 per cent and 1.7 per cent, respectively, the lowest in more than three decades. In the sixteen years after 1988, inflation was in double digits in seven of those sixteen years, while previously in the 40 years between 1947–87, inflation was in double digits on only seven occasions. Even the State Bank of Pakistan's Annual Report for 1996/7 admitted that 'almost all macroeconomic indicators showed that 1996–97 was one of the most difficult and disappointing years in the economic history of the country'.[34] Another government report accepts the fact that since the growth rate of real per capita income was about 1.3 per cent in the period 1991–98, it 'has been very low to make any dent on poverty'.[35]

At one stage manufacturing had been the leading sector in the economy, with growth rates averaging 9.1 per cent between 1980–88; this rate fell to an average of 4.9 per cent for the period 1988–97, falling to a minus 0.1 per cent in 1996/7, the lowest in the last thirty years and was 1.5 per cent in 1999/00. As an obsession to cut the fiscal deficit, public expenditure was cut, and development expenditure in particular, has borne this brunt. From a high of 9.3 per cent of GDP in 1980/1, development expenditure fell and in 1997/8, only a little over three per cent of GDP had been allocated under this head; in 2000/1 this had fallen to 2.1 per cent only. Additionally, remittances, which had played such an important role in the 1970s and 1980s in alleviating poverty, declined by about 41.8 per cent (in constant prices) between 1982/3 and 1995/6,[36] and in 1996/7, were the lowest since 1978/9.

Public sector employment, historically an important anti-poverty measure, had fallen, while wages decreased in real terms: real wages, which increased by 0.7 per cent between 1980–91, fell by 2 per cent between 1991–95;[37] public sector employment is estimated to have fallen by ten per cent during 1990–93, and 43.2 per cent of workers previously employed in public enterprises were laid off by their new employees.[38] Moreover, it has been seen that 'overall unemployment in occupations with a high incidence of the poor has dramatically increased and real wages of skilled and unskilled labour sharply declined. In addition, subsidies that were critical to the consumption pattern of the poor have been cut while the burden of indirect taxes on the poorest income group has increased. Not surprisingly, there has been an increase in poverty and inequality, particularly in the rural areas'.[39] Providing statistical evidence for these figures, A. R. Kemal,[40] had shown that the share of wages in national income fell from 32.3 per cent in 1987/8 to 30 per cent in 1990/1, and personal income distribution which improved between 1979–88, worsened considerably between 1987–91, with the overall Gini coefficient increasing from 0.35 in 1987 to 0.41 in 1991; in rural areas, the Gini coefficient increased from 0.307 to 0.41 in the same period.[41] In addition not only was there a cut in food subsidies of 22.4 per cent between 1991–95,[42] there had been a cut in subsidies from 2 per cent of GDP in 1988/9, down to only 0.5 per cent in 1996/7.[43] Moreover, the 'rationalized' tax structure had resulted in more indirect taxes, with a decline of 4.3 per cent of the tax burden on the rich, with an increase of the tax burden by 10.3 per cent on the poor.[44] The rate of unemployment which was 3.1 per cent in 1987/8, had increased to around 5.4 per cent in 1997/8, with more than two million unemployed. The Government of Pakistan estimated that the extent of underemployment was around 20 per cent of the labour force, and that as many as 1.3 million persons would enter the job market each year adding to the pool of the unemployed, as at least half of these 'cannot expect to find work at the present rate of labour absorption'.[45] It feared that 'the problem of unemployment may intensify further'.[46]

It is important to emphasize that while these numbers show a very obvious downward trend between 1988 and 2004 when the Structural Adjustment Programme was introduced, we cannot *prove* that this was on *account* of the programme alone, since there are numerous other factors which have also affected the economy since 1988. Nevertheless, given the dramatic changes that took place as a consequence of the programme, commonsense suggests that it was more than likely that the adjustment programme had a large contribution to play in this downtrend.[47]

Every single indicator which had some poverty reducing impact, such as economic growth, manufacturing sector growth, employment, public expenditure, development expenditure, remittances and subsidies, deteriorated over the 1998–2004 period. The impact on poverty should be equally clear. It is no surprise then, that poverty increased in Pakistan, quite considerably in this period. However, as Chapter 18 on the post-9/11 Musharraf period shows, Pakistan's economy saw an about-turn after around 2002 or 2003, as a consequence of Pakistan's role in the war on terrorism. While some of those factors and consequences are discussed in detail in Chapter 25, on war and aid, the impact on poverty was highly positive, as Box 22.6 above has also shown. The temporary boom in the period 2002/3–2007/8 certainly resulted in rising incomes as well as lowering poverty, as has been shown above, but in the post-2008 period, a number of factors affecting the economy, suggest that poverty has risen from the 17.2 per cent figure cited above. The change in government in 2008, the economic slowdown domestically, economic recession globally, floods in 2010 and 2011, an IMF programme in 2009, the costs of the war on terrorism, militancy and terrorism within Pakistan, rising food and fuel prices, and such serious shocks to the Pakistani system and economy, are bound to have caused poverty to rise after 2008. However, since there is no data available to quantify the increase, we really don't know how much poverty has risen. There have also been some positives as well after 2008, which might suggest that poverty might not have risen as much as it is feared. The two main poverty mitigating factors are likely to be the increase in support prices for wheat and rice, which have had a positive

Box 22.6

Has Poverty Fallen Between 2008–12?

Although data is lacking about poverty statistics and there are questions about the trend in poverty from around 2008 onwards, some newspaper reports have suggested that despite poor economic conditions, poverty may have continued to fall after 2008.

Despite deterioration in the macroeconomic situation, the incidence of poverty declined by 4.8 per cent to 12.4 per cent in 2010–11 against 17.2 per cent in 2007–08, according to findings of a committee constituted by the Planning Commission.

A committee of experts established by the Planning and Development Division under chairmanship of G. M. Arif of the Pakistan Institute of Development Economics (PIDE) and comprising of other experts in its report disclosed that inequality also improved in Pakistan in the wake of increased consumption expenditures in the last five years among the lowest quintile of income groups than in other quintiles.

The Planning and Development Division stopped the release of poverty findings on the pretext that how would government justify the lowest ever poverty level despite low growth, high inflation and unemployment in the country.

According to poverty analysis done on the basis of data obtained through Pakistan Social Living Standard Measurement (PSLM) survey in 2010–11, overall poverty declined to 12.4 per cent with urban poverty of 7.1 per cent and rural poverty of 15.1 per cent. The level of poverty in 2007–08 was standing at 17.2 per cent that was also not endorsed by the Planning Commission at that time under the PPP-led regime, with urban poverty of 10 per cent and rural poverty of 20.6 per cent.

The report of the committee stated that the major challenge, which the committee has not addressed, is how to explain these poverty and inequality trends in the wake of macroeconomic situation that prevailed during the last four years i.e. low growth, high inflation and unemployment.

The committee recommended that first the poverty estimates may be validated using the same methodology by poverty experts, as was done in the past and second the Household Income Expenditure Survey (HIES) 2010–11 may be released to enable researchers and institutions in public and private sectors to use it for poverty analysis so a healthy debate on poverty trends, methodology and quality of HIES data may be generated.

According to the report, for poverty estimation in Pakistan, the official poverty line, based on threshold of 2350 calorie intake per adult per day is applied on the micro data generated by HIES.

The Federal Bureau of Statistics (FBS) carried out the HIES 2010–11 from July 2010 to June 2011, in all four provinces, with total sample size of 16341 households including 6580 households from urban areas and 9752 from rural areas.

For poverty estimation, the official poverty line has been adjusted by inflating it with Consumer Price Index (CPI) data between the two survey period as in case of 2007–8 and 2010–11 the CPI stood at 52 per cent. The inflated poverty line for 2010–11 is calculated at Rs. 1745 per adult equivalent per month compared to Rs. 1142 per adult per month for 2007–08. The household expenditure data was also adjusted to get adult equivalent consumption expenditures.

Discussing consumption behaviour of household in accordance with HIES 2010–11, the committee found that the per capita monthly consumption of wheat slightly increased between 2007–8 and 2010–11. However, wheat consumption in 2010–11 is lower than earlier periods 2000–1, 2004–5 and 2005–6. Same is the case for rice consumption. The consumption of pulses and vegetable increased but decline observed in milk consumption. There is no considerable difference between urban and rural areas in terms of per capita consumption of different food items except that the decline in milk consumption is higher in rural areas than in urban areas, the report said.

The committee reports that the analysis of consumption behaviour demonstrated an improvement in the wellbeing of households that also reflected in the poverty statistics. With poverty level of 12.4 per cent in 2010–11, this is ever lowest level of overall poverty in Pakistan. There is marked decline in overall as well as urban and rural poverty during the last decade.

The overall poverty declined from more than one third 34 per cent in 2000–1 to only 12.4 per cent in 2010–11. The decline was highest 10 percentage points between 2000–1 to 2004–5 but the decline between 2005–6 and 2007–8 and between 2007–8 and 2010–11 was also substantial, 5.8 per cent and 4.8 per cent respectively.

G. M. Arif, head of the committee, when contacted on Saturday said that they have proposed to the government to conduct broader consultation on data as well as methodology to come up with facts on poverty trends in Pakistan.

Source: Haider, Mehtab, 'Poverty Declined During Last Five Years: Report', *The News*, Karachi, 22 July 2012.

impact on farmers' incomes, and the substantial increase of remittances sent to Pakistan, around $12 billion in 2012. Both factors have a considerable impact on poverty alleviation, but given numerous other negative factors, it is not clear which set of factors have a larger influence. Only research and hard data, if ever available to the public, will quantify the nature, extent and even direction of change from the mid-2000s—see Box 22.6 and 22.7.

22.6 Poverty Alleviation

What emerges from the discussion above, is that poverty alleviation has taken place via the mechanism of economic growth, high remittances and active public policy, rather than specific policy designed to alleviate poverty, i.e. poverty alleviation schemes, as such. There have been some special development programmes, like the Junejo government's

Box 22.7

Rural Poverty Dynamics in Pakistan: 2012

PIDE released its PIDE Viewpoint in October 2012, highlighting some keys aspects of rural poverty in Pakistan. Some excerpts:

A close look at the data on poverty levels and trends in Pakistan for the last five decades leads to two broad conclusions. First, poverty reduction has not been sustainable rather it has fluctuated remarkably. Second, a large proportion of the population has been found around the poverty line, and any micro and/or macro shock (positive or negative) has pushed it into poverty or pulled it out of it. . . .

. . . Poverty reduction trends in the past show a high mobility of population into or out of poverty. This mobility suggests that a higher proportion of population experiences poverty overtime than what the cross-sectional data might suggest. It also implies that a much smaller proportion of the population experiences chronic poverty; that is remaining poor for a long period, relative to those poor who are enumerated on cross-sectional observations in a particular year. . . .

. . . In rural Punjab and Sindh, poverty decreased from 31.3 per cent in 2001 to 24.1 per cent in 2004; but it increased to 27 per cent in 2010. By taking into account the data for all provinces, which is available for 2001 and 2010 rounds, the poverty has declined by 5 percentage points from 27.5 per cent in 2001 to 22.4 per cent in 2010. The change (or decline) in poverty levels between the 2001 and 2010 period is therefore marginal at only 1.5 percentage points. . . .

. . . A regional analysis shows that in north/central Punjab, poverty remained almost at the same level between 2001 and 2004 period while in southern Punjab and Sindh it first declined between 2001 and 2004 and then increased between 2004 and 2010. In southern Punjab, the increase in poverty between 2004 and 2010 is much larger than the decline between 2001 and 2004, thus showing a net increase in poverty between 2001 and 2010 period.

The key message from the above analysis is that, as in the past, poverty during the last one decade has also fluctuated. This fluctuation has largely happened in rural areas of Sindh and southern Punjab. . . .

. . . The movement out of poverty out-numbered the movement into poverty in 2001–04 period, but more people fell into poverty than those who escaped poverty during the 2004–10 period. . . . The well-being level of rural population in 2010 is not worse off than their level in 2001, rather it can be considered modestly better off. . . .

. . . Chronic poverty is found higher in southern Punjab than in Sindh or in north/central Punjab, particularly the latter. . . .

. . . moving into or out of poverty is relatively more common among households headed by less educated persons, and having no ownership of land and livestock, suggesting the structural nature of rural poverty in Pakistan. Shocks such as inflation, flood, and drought have played a key role in the past in poverty movements. . . .

. . . moving into and out of poverty is a common phenomenon in rural Pakistan. This movement directly depresses the desired status of 'never-poor'. Rural poverty is more persistent in Sindh and southern Punjab than in north/central Punjab . . . [L]ack of assets (land and livestock), low human capital (education), shocks (inflation, flood, drought etc.) and high dependency ratios are the major factors for the persistence of rural poverty in Pakistan. . . .

Source: PIDE, 'Rural Poverty Dynamics in Pakistan', *PIDE Viewpoint*, October 2012.

Five Point Programme, which had a focus on employment generation and on infrastructure development, but again, not specifically with a poverty alleviation focus. It seems that poverty has been reduced in the past through other linkage mechanisms, rather than through a direct 'assault' on poverty itself. This has been the case even when poverty was at its greatest heights in the 1960s, when explicit poverty reducing policies did not really exist. There does not seem to have been a conscious effort to alleviate poverty in the past, and most of the reduction may have taken place primarily as a result of positive externalities. It is only of late, after around the mid-1990s, when there had been a scare regarding poverty and direct attempts to reduce it had been devised.[48] However, before we examine this strategy for poverty reduction it might be worthwhile to consider in some detail, what may have been the best and most effective poverty alleviation mechanism in Pakistan, that of remittances, a factor which continues even till today.

References to the role of Middle East remittances from 1975 to the end of the 1980s—and again in the late-2000s—in the sections above, have accentuated the significance they had on growth and on poverty alleviation. However, what is often overlooked, is the *mechanism* through which remittances act as a poverty alleviating device.[49] It has been argued that 'large-scale migration to the Middle East became the single most important economic event in Pakistan during the 1970s and 1980s. No other occurrence had such a pervasive impact on so many areas of Pakistan's economy and society'.[50] Most of the migrants from Pakistan came from rural areas and many 'thousands of rural Pakistani families participated in the employment and remittances boom in the Middle East'.[51] More than two million people were sent abroad, out of which at least 1.2 million were from rural areas. There was widespread participation from the *barani* districts of the Punjab and the NWFP, which represented some of the poorest districts of the country: 'in this sense, the Middle East migration had a certain redistribution aspect in that it provided at least temporarily exaggerated income streams to some areas where opportunities for productive employment were extremely limited'.[52] Household incomes for a few years were seen to have been increased by anything between two to four times. The sectors whose growth of output were affected most by the increased demand generated by remittances, included the small-scale sector, construction,

transport and communications and wholesale and retail trade, especially in rural and peri-urban areas. Increases in incomes, especially for poorer families, resulted in increased expenditure on food, clothing and shelter.[53] Because of the individual nature of decisions about consumption, savings and investment, the developmental impact of remittances resulted in 'diffused, decentralized modes of development'.[54] In comparison, 'official development expenditures reaching individual villages in the less developed *barani* areas paled in comparison with income generated by migrants themselves'.[55] It was not only the large number of migrants and their families who benefitted, but local economies were also transformed in many ways, with local produce (milk, fruits, vegetables, etc.) being in greater demand as incomes rose, which 'enhanced the impact of remittance spending locally, increasing incomes and employment opportunities for villagers not directly involved in migration'.[56] Many returning migrants opened shops and hotels, started taxi services, opened small workshops, all of which had similar results. There were visible aspects of change, such as 'increased transportation, improved housing, high rural incomes, more diversified village economies, decentralized decision making, expanding availability of consumer goods, and so forth'.[57] As Burki writing in 1988 argued, 'the reason why Pakistan seems to be relatively free of absolute poverty has less to do with deliberate government policy; it is more the result of remittances from the Middle East'.[58]

It was only in the late 1990s that the government actually accepted the existence of poverty and acknowledged that not only did it exist, but that it had increased over the previous decade. With Task Forces and Working Groups set up to provide insight into the persistence of poverty, many programmes for the alleviation of poverty were announced, and even included as a 'strategy' in the Ninth Five-Year Plan. Unlike the previous non-strategy, where the government was mainly involved in running the economy and in providing developmental expenditure and services, the later strategy was premised on a far more active and involved role for government in poverty alleviation. *Government entered as an active agent in the process of poverty alleviation.*[59]

The main components of the Human Development and Poverty Reduction Strategy included the following:[60]

- substantial economic growth, at a fast pace, resulting in an increase in per capita income; sustainable economic growth is to take place through infrastructure development, taxation reform, financial sector development, a restructuring of the manufacturing sector and an overhauling of the agrarian system; growth is to be labour intensive and 'people friendly';
- to provide employment opportunities to counter the recessionary trends and to provide employment for poverty reduction;
- expand and improve the quality of social services;
- mobilization of support organizations, NGOs and partnerships with the private sector;
- community based participatory development programmes;
- a system of social safety nets;
- microcredit programmes for the poor;
- development of human resources and basic skills;
- information needs for poverty policy;
- empowerment of women; and
- the issue of governance.

Earlier, a Working Group on Poverty Alleviation and the Task Force on Poverty Alleviation, included:

- setting up small-scale industrial sectors;
- national reconstruction corps;
- setting up various training institutes;
- schemes for the eradication of child labour; and
- setting up of Rural Support Organizations.

On paper, at least, it seems that the objectives, intentions and approaches of the Poverty Reduction Strategy and of the Task Force and the Working Groups, seem well meaning. However, examined at closer quarters, most, if not all, attempts were likely to fail or to fall far short of any meaningful targets. There were three main criticisms which made such strategies somewhat less meaningful, in dealing with issues related to, firstly, macroeconomic objectives having an impact on employment, growth and public expenditure; secondly, issues of targeting; and finally, issues related to the nongovernmental organization sector and community participation.

The economic strategy of the government which announced these ambitious goals, continued to be that of structural adjustment. Almost every study that has critically examined the impact of such economic programmes, has emphasized the negative impacts on growth, employment, public expenditure and on poverty—see Box 22.5. Even the World Bank (1995) which is a strong proponent of the Structural Adjustment Programme, acknowledged that there were significant transitionary costs—however, how long this transition is to continue and when, if ever, these trends improve, was never made clear. Even the Government of Pakistan accepted that there were very serious consequences of following this policy:

> Pakistan's economic reform agenda calls for major structural changes, the burden of which has and is likely to fall largely on the weaker segments of the population. In the past, rising unemployment, inflationary tendencies and high cost of essential imports, all have had an adverse impact on the poor. Fiscal expediencies increasing reliance on the indirect and regressive measures in taxation, continued decline in the ratio of PSDP (Public Sector Development Programme) to GDP, privatization, have also placed a significant proportion of the transitional burden on the poor with increases in unemployment. . . . One major area of concern is to prevent poverty increases in the transition period, particularly in view of declining public sector expenditures and its negative impact on employment generation.[61]

This analysis continued with an extensive list of the negative consequences of following the Structural Adjustment

Programme, and the realization that these policies gave rise to the then 'current recessionary situation'. It argued that as a consequence, there was an 'adverse impact on employment, increase in poverty and more importantly vulnerability of those above the poverty line to the poverty trap, caused by a massive reduction of employment opportunities, reduction in construction activity across the country and an overall depression in economic activities'.[62] Having realized what had happened in the past, nevertheless, the government was 'committed to reduction of budget deficits and other stability measures. . . . [L]imitations on the size of the development programme and limitations on its pro-poor nature may adversely impact the unemployment problem'[63] [sic.]. In light of these trends, a senior government official concluded, that 'in this environment, poverty as a concern cannot figure prominently'.[64]

Other writers found that although the slowdown in economic growth in the 1990s had serious consequences for poverty reduction, the subsequent economic agenda of the government continued to be that of the earlier years, with the opening up of the economy, reduction of subsidies and more privatization and liberalization. These so-called reforms, 'have not yielded tangible benefits in terms of growth or poverty reduction',[65] and the context for poverty alleviation or elimination, was not as promising later as it was in the 1980s. In order to address the problem of poverty, Shahid Javed Burki, argued that the economy needed growth at 'twice the increase in population growth to make a serious difference in the incidence of poverty'.[66] A growth rate of between 6 to 7 per cent each year for some years, at a consistent pace, looked unlikely given trends in economic growth till the miraculous turnaround in around 2002 or 2003—see Chapter 18 also. Given the experience since 1988, it seems that few of the major macroeconomic indicators affecting growth and poverty would have improved, making many of the government's initiatives for its Poverty Reduction Strategy redundant. The so called transitionary period continued for a fairly long time, until events after 9/11 changed Pakistan's economy and much else.

Some of the initiatives proposed by the government at that time required effective targeting if any worthwhile results were to be accomplished. Also part of the Strategy were social safety nets which were put in place in the form of *zakat*, *ushr*, and the *baitul maal*, all of which required effective targeting. Moreover, the increased, direct, involvement of government in the lives of the poor, would also have required efficient delivery. The evidence available about the government's targeted schemes does not confer much confidence in such schemes. Findings have shown that the system of *ushr* is 'moribund', and the system of *zakat* 'is not working effectively'.[67] These social safety nets are said to have low benefits and their 'coverage is generally low and amounts disbursed do not constitute a significant contribution to household budgets, and do not provide a springboard to lift the poor out of poverty'.[68] As Burki argued, despite these schemes, 'government support for the poor remains insignificant', and, 'the State in Pakistan has failed to erect a strong safety net that can catch those people who fall into the trap of poverty as a result of economic and social changes'.[69] Numerous cases were cited which suggested that the mechanism for social safety nets was seen as 'being both inefficient and corrupt', and corruption, patronage, political influence and pilferage, appeared to be widespread problems. Hence, 'in the current administrative climate and in the context of high levels of popular scepticism and mistrust, developing strategies for sustainable social assistance programmes cannot be separated from the issue of governance'.[70] The high profile, much publicized, donor-funded Social Action Programme, may have just helped in keeping the level in government expenditure in a few social sectors at their previous levels despite overall fiscal cuts, but evaluations of it, have been extremely critical[71]—see also Chaper 20 in the Second Edition where the Social Action Programme was discussed at length. Institutional failure and issues of 'governance' have always been a key feature resulting in the poor quality of focused government intervention. Whether such new strategies, with government as an active agent, given existing governance structures, would be able to overcome these structural constraints to better targeting in the future, is highly questionable. In fact, perhaps the now discontinued, general subsidy scheme—on wheat, fertilizer and on other inputs—despite numerous problems, may have been a better mechanism to address issues of poverty, rather than the many targeted schemes.[72]

Although there is growing lip service paid to the role of 'community' participation and the role of NGOs, there is also wide recognition that in the context of Pakistan, with the exception of a very few NGOs, most are not particularly effective. Moreover, it is felt that even the few participatory development NGOs which reach out to poor communities, 'do not necessarily reach the poorest within them'.[73] Even the government, which had begun promoting the role of NGOs, recognized that 'very few NGOs are working on poverty alleviation, participatory development, gender equity and capacity building at the grassroots level. Very few of them have well-defined governance, transparent and accountable structures. Large number of NGOs relies [sic] entirely on financial support from the government and international donors. Their survival as a sound financial entity is questionable in the absence of sound financial support'.[74] Extensive evidence from the rural water supply and sanitation sector, which was one of the main components of the Social Action Programme, shows that NGOs were not yet capable of taking over government built water schemes, and the expectations that 'communities' and NGOs would be able to do development, were highly exaggerated.[75] Yet another pillar in the plank of the Poverty Reduction Strategy came unstuck.

Microcredit schemes and the Rural Support Organizations proposed under such poverty alleviation strategies, have also been criticized by Haris Gazdar. He argued that the proper perspective on microcredit has not been recognized by the government in its strategy, where the poor need credit not so much for asset creation as the strategy sees it, but for consumption smoothening and as an insurance against adverse shocks. He also questions the concept and governance structures of Rural Support Organizations, and

argued that these proposals 'fail to spell out adequately the governance structures in these organizations, their responsiveness and accountability to central and provincial governments, their relationship with existing "community mobilization" initiatives, and their relationship with the elected government'.[76]

This critical evaluation of this Poverty Reduction Strategy, seems to suggest that perhaps the poverty alleviation mechanisms of the 1970s and 1980s were far more productive than the subsequent ideas generated by the government. Moreover, evidence from the 2002–08 period also suggests a resort to the earlier poverty alleviation strategy, *of high growth in the economy, high remittances, and employment generation*, compared to direct interventions as mentioned above. Conditional or unconditional cash transfer schemes, such as the Benazir Income Support Programme (BISP) started by the People's Party government which took office in 2008, are meant to reach millions of the poor, particularly women. Evidence from countries such as Mexico and Brazil, both of which have had cash transfer programmes, or from India, where a rural employment guarantee scheme has been existence for some years, show that targeted programmes can work very effectively. There is as yet, little evidence from the BISP that it has helped alleviate poverty appreciably. It is clear that the Rs. 1,000 handed over to poor women raises their income and consumption, but given the double-digit inflation, especially of food, since 2008 when the BISP was started, the real amount which women receive now, is far less in 2013 than what it was in 2008. The sum they receive is not inflation-adjusted, and the benefit received by women, would have fallen. Having said that, after receiving some cash transfers, total income would have increased. However, because as yet there is no hard evidence of the impact of the BISP, it is not clear what purpose the scheme has served except for a small increase in income received by the household. There is also anecdotal evidence of corruption and mismanagement in the BISP. Pakistan's record over 55 years shows, that the best way to alleviate poverty is to have high growth which is well distributed by location—remittances are well-distributed—and that jobs are created, perhaps through enhanced public sector spending. In the period 2008–13, of these three, only remittances have shown signs of growth and improvement—see also Box 22.8.

22.7 Poverty and Bonded Labour

It seems that 'bonded labour' has been around in Pakistan for centuries, and is embedded and sanctified by traditional and cultural social and economic practices. Nevertheless, despite its presumed historical presence, there is considerable confusion over the term 'bonded' labour and for this reason, perhaps, there is almost no empirical evidence to support the claims of the nature and extent, and even existence, of what is called bonded labour. Anecdotal evidence, based on different perceptions of what bonded labour is—depending on the researchers' definition, whether they take a tighter, stricter, definition, or a more general, economic and occupational term to define 'bonded' labour[77]—is increasingly making news and is being brought to the public's knowledge. Moreover, even though there is some ambiguity about the precise nature of the definition of bonded labour, keeping a consistent definition over a period of time, evidence suggests that the nature and the extent of bonded labour is undergoing considerable change. This section of this chapter examines the nature of bonded labour in Pakistan, using previously published studies, despite the substantial paucity of concrete data, to draw some inferences about the general characteristics of what one calls bonded labour.

Not only is there no consensus regarding the definition of bonded labour amongst those who have researched the theme, there is also no agreement on the occupations/ professions in which it presumably exists. In terms of severity and expanse, it seems that landless sharecroppers, particularly in southern Sindh and somewhat in southern Punjab, are the largest category and suffer the most, followed by agricultural wage workers in these two regions, followed by brick kiln workers primarily in the Punjab and in NWFP. These two categories probably make up the major proportion of an as yet unquantified and ill-defined category of bonded labour. Carpet weaving and fisheries are probably the other industries where bonded labour is said to exist, although according to Anti-Slavery International, 'there are many other sectors of employment in which bonded labour has been the norm rather than the exception'.[78]

'Bonded' labour can be of at least two kinds: workers who are 'bonded' and have debt obligations to their employer where indebtedness actually defines the nature of their being bonded; and under more so called traditional or tribal settings where the nature of being bonded to the *sardar* or tribal leader does not necessarily incur debt, but may derive out of other forms of dependence and bondage, such as loyalty, protection or other cultural and social forms of allegiance.[79] Our interest in this chapter is primarily with the former kind, i.e. debt bondage.

One can explain the nature of debt bondage as follows: 'instead of just seeking wages in exchange for their work, poor people, in both rural and urban areas, take an advance from an employer, in money or in kind, and are obliged to work for that employer until they have paid off their debt. The loan, [is] known . . . as *peshgi*'.[80] However, this relationship is not as simple or straightforward as the above definition may imply. According to the Bonded Labour System (Abolition) Act 1992, an advance (*peshgi*) becomes a 'bonded debt' under which a bonded labourer is forced to work for his employer/creditor, where the bonded labourer would '(i) render, by himself or through any member of his family . . . labour or service to the creditor, or for the benefit of the creditor, for a specified period or for an unspecified period, whether without wages or for nominal wages, or (ii) forfeit the freedom of employment or adopting other means of livelihood for a specified period or an unspecified period, or (iii) forfeit the right to move freely from place to place, or (iv) forfeit the right to appropriate or sell at market value any of his property or product of his labour of a member of his family or any person dependent on him, (v) and includes the system of forced, or partly forced labour under which a surety for a debtor enters . . . into an agreement with the creditor to

Box 22.8

The Causes of Poverty in Pakistan

An extensive study conducted by Abid Burki and his colleagues at LUMS examining industrial policy and its spatial aspects, also examined many factors which affect poverty in Pakistan. Excerpts:

I. The World Bank (2002) highlights the importance of a range of household characteristics that are found to be the cause of poverty in Pakistan, which include, among others, land and livestock assets, education of the household head, size of the household and nature of employment of household head. We use recent household data to verify the influence of these factors on the incidence of poverty in Pakistan. We explore the characteristics of poverty among households by using PSLM 2005–06 data.

In Table 5-1 we show the incidence of poverty on the basis of these household attributes by taking data of both urban and rural areas. The numbers in Table 5-1 illustrate that no land households are 68 per cent of the total, but their incidence of poverty is highest at 23 per cent in the full sample. However, the incidence of rural poverty inlandless households is much higher at 31 per cent. In general, there seems to be a negative association between the size of landholding and the incidence of poverty and this relationship holds more strongly in rural than in urban households. Similarly, incidence of poverty in rural livestock households is relatively much lower than non-livestock households. Head education has the most powerful but negative effect on poverty incidence in both urban and rural households. The incidence of poverty on households with illiterate head is 57 per cent, lowly and medium-educated head, 17 per cent and 19 per cent, respectively, and for highly educated head poverty is only 5 per cent. A similar picture emerges from the urban and rural households. Poverty incidence on large-sized households is 34 per cent compared with 16 per cent in medium-sized and 3 per cent in small-sized households in the national sample. The incidence in urban and rural households is a similar story. Finally, the employment status of household head is also an important determinant of urban and rural poverty. We can see that the incidence of poverty is high in paid employees and unpaid family workers as compared with self-employed and unemployed household heads. . . . [329–31]

Table 5-1 Incidence of Poverty by Household Characteristics: 2005–06

	Urban		Rural		Overall	
	Head count poverty (%)	% of population	Head count poverty (%)	% of population	Head count poverty (%)	% of population
Poverty by household land ownership:						
Household has no land	13.6	96.0	31.1	54.3	22.8	68.4
Household had subsistence land holding (1–12.5 acres)	20.6	3.3	22.8	39.0	22.7	27.0
Household has economical land holding (12.6–25 acres)	2.4	0.4	14.2	4.3	13.7	2.9
Household has large land holding (more than 25 acres)	0.0	0.3	13.1	2.4	12.3	1.7
Poverty by livestock ownership of household:						
Livestock household (Yes=1, no=0)	15.5	3.2	23.4	36.3	23.0	25.2
No livestock household (Yes=1, no=0)	13.7	96.8	28.7	63.7	22.1	74.8
Poverty by education of household head:						
Illiterate head (no education)	26.3	32.4	33.0	56.8	31.5	48.6
Lowly educated head (1–5 years)	14.2	16.0	24.7	17.0	21.3	16.7
Medium educated head (6–10 years)	7.5	31.0	16.6	19.9	12.6	23.6
Highly educated head (more than 10 years)	3.0	20.6	8.1	6.3	4.9	11.1
Poverty by household size:						
Small sized household (1–3 members)	1.3	4.7	3.9	4.7	3.0	4.7
Medium sized household (4–8 members)	7.3	58.8	20.2	53.3	15.6	55.2
Large sized household (more than 8 members)	25.8	36.5	37.6	42.0	34.0	40.2
Poverty by employment status of household head:						
Unemployed	16.8	19.5	23.9	16.2	21.2	17.3
Self employed	12.8	32.2	22.2	50.9	19.9	44.6
Paid employee	13.0	48.1	35.5	32.0	25.7	37.4
Unpaid family worker	40.0	0.2	21.9	0.9	24.1	0.7

Note: Authors' calculations from PSLM-HIES 2005–6

II. Estimated coefficients indicate consistent negative impact of education of household head and ownership of household assets (including land, livestock, farm equipment and financial assets) on poverty. For instance, there is unequivocal evidence to show that poverty coexists with illiteracy of heads of household and lack of asset ownership. Our results show that the incidence of poverty dramatically falls with increase in education of household head. The results in column (4) suggest that compared with illiterate heads, poverty falls by 8.9 per cent when head has one to five years of schooling, 15.5 per cent when heads has six to ten years of schooling and 25 per cent when head has more than secondary education. The probability of being poor progressively falls as household land wealth increases from subsistence landholding, to economical landholding and then to large landholding. Ownership of farm equipment is also negatively associated with the incidence of poverty in rural Pakistan. Livestock households are significantly less likely to be poor than non-livestock households.

In household level factors, the family size makes the most significant difference on poverty. Increase in family size consistently increases poverty in our sample. Relative to small-sized households (1 to 3 members), the likelihood of poverty increases by 36 per cent for individuals coming from medium sized households (4 to 8 members) and to almost 59 per cent for individuals from large-sized households. In other words, scale economies often attributed to larger households do not exist in rural Pakistan. In the individual level control variables, the coefficient on age is significantly negative suggesting that younger population is more likely to be poor. Given that the majority of Pakistani population is young, this result is alarming. The incidence of poverty on male and female population is roughly similar, except that males are 0.06 per cent less likely to be poor than females. Increase in the number of days worked significantly decreases the probability of poverty in our sample. . . . [342]

Source: Burki, Abid et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 2010).

the effect that, in the event of failure of the debtor to repay the debt, he would render the bonded labour on behalf of the debtor'.[81]

The main feature of the bonded labour system is that a debt is owed, which gives rise to an exploitative and 'bonded' nature of relationship between the creditor (in this case, presumably the employer rather than a third party), where the employer can restrict the movement of the debtor, restrict his right to work elsewhere, expropriate the employee's output which the employer can sell in the open market and can get forced labour out of him until that time the debt is repaid.[82] The fact that the debt is seldom repaid and is passed on from one generation to the next, is an equally important aspect of this relationship.

Although the nature of debt bondage and of the bonded labour system is not occupation-specific, it has been seen to be severest in Pakistan under the sharecropping (*hari*) system and in the brick making industry. The sharecropping system in agriculture is based on, either a 50:50 or 25:75 sharing system where tenants on the land of a landlord provide certain inputs and share in the eventual crop produced. Sharecropping still exists in lower Sindh and in southern Punjab. Although, according to one survey conducted in three districts in Sindh, 100 per cent of all rural/agricultural households were in debt,[83] this does not mean that all were in debt bondage or were bonded labour. It is important to emphasize the point that while the incidence of debt is likely to be widespread amongst poor rural households and amongst *haris*, not all are bonded labour. Debt-related bonded labour requires many of the characteristics identified above, particularly extra-economic coercion, and probably also some degree of violence. This issue is important as we proceed to show below.

According to an ActionAid study, *haris* were 50–60 per cent of the population of rural Sindh, which works out to a population of around 8 million in Sindh alone, or perhaps between 0.8–1 million *hari* families which cultivate land under sharecropping arrangements in the province.[84] The PILER study on bonded labour which defines bondage simply as 'the imposition of unpaid or nominally paid compulsory labour for the landlord on his own farm or house (*begar*) regardless of the size of the debt'[85] using upper and lower bounds, estimated between 1.8–6.8 million persons in bonded sharecropping families *across Pakistan*. Given the lack of statistics and adequate data, either about overall debt or its bonded nature, and large differences in definition, such huge discrepancies between different estimates are likely to arise. Nevertheless, if one was to consider even the lower end of the PILER estimate, regardless of severity of bondage, we would account for five per cent of the current 40 million below the poverty line in Pakistan.

It is also necessary to highlight the fact that even if all sharecroppers were not formally bonded, a very great proportion are likely to be counted amongst the poorest of the poor in the country and ought to be the beneficiary of a focused poverty eradication/alleviation programme. Indeed, some observers would even argue that given the difficulty to either expressly define or, certainly, to quantify, bonded labour, the real issue ought to be better and improved tenurial arrangements which address the issue of poverty.

Almost all *haris* are indebted to landlords who control the labour of the *hari* in exchange for the loan. The landlord decides what crops are to be sown and the amount of land to be used for crop production. After a proportion of the loan has been deducted, the produce in the form of cash, or more usually crops, received by the *hari* is barely enough for

subsistence, so the *hari* is forced to borrow again from the landlord each year or each crop-cycle. A large proportion of *haris* are unable to survive from the produce of a year's crop even if they do not have large amounts of debt outstanding, and within six months need loans to be able to survive—consumption loans—as well as for productive purposes as input into the next crop. Usually, their only source of credit is the landlord to whom they are already indebted. Records for such loan transactions are almost never kept by the *haris* who cannot read or write, and the extent of previous debt and the arrangement over inputs and outputs is decided almost exclusively by the landlord. Moreover, until the loan is paid up, the *hari* is not allowed to seek employment elsewhere, and is unfree, and hence, regardless of the size of the debt, the *hari* is in a debt-bondage situation.

The PILER Study argued that 'conditions of bondage are both a result and a sustenance of unequal economic and political power'.[86] As a result of this extra-economic coercion, which is often overlooked, if not totally ignored, due to the attitude of the local level administration—police, justice, officialdom—cases of the landlord or his employers resorting to violence and rape, are not uncommon even when the original relationship may have been mainly one of a debt owed. Beatings and sexual abuse of women, are often heard of, and many such landlords maintain private jails so that the indebted *haris* do not flee. Issues of poverty, more generally need redressing, but perhaps equally importantly, do those of violence. One of the many reasons why the local district administration turns a blind eye to the issue of violence of bonded *haris*, is that most such *haris* belong to religious and ethnic minorities, many are migrants, and are considered 'marginal' to the mainstream and have less access to justice than even Muslim *haris* and landless sharecroppers.

Many of the debts which sharecroppers face, have been contracted by their forefathers and have been inherited. Estimates about the extent of the loans show, that on average the loan in the NWFP was Rs. 32,000, and Rs. 16,000 in Sindh.[87] Some studies show that *hari* families can survive on their produce only for a few months each year and the average value of a crop a Sindhi *hari* receives is Rs. 1,200–1,500 per month, which is generated only for three or four months. Debt is an expected outcome given low income, past debt and higher expenditure. Since landless *haris* seldom own assets, they are not entitled to loans or credit from formal or even informal sources, and hence have to turn to the landlord. Clearly, given the tenurial relationship, lack of assets, primarily land and no credit line, it is not surprising that sharecroppers are indebted and many are bonded labourers.

Of the five studies referred to above on bonded labour, three deal explicitly with Sindh, hence their emphasis on sharecroppers. Only the PILER study and the one by Anti-Slavery International examine the case of other occupations which give rise to bonded labour. The PILER study estimates that the upper limit of bonded labour and their families in brick kilns would be close to 1 million across Pakistan,[88] although since there has been no survey, there is no way of verifying this number. The study argues that like the case of *haris*, those bonded here also mainly belong to a religious minority, in this case, Christians. In the surveys conducted by PILER for their study, owners of brick kilns confirmed that all workers took advances and loans and these were to be adjusted against workers remuneration, and almost all brick kiln families were found to be in debt to the employer.[89] The Anti-Slavery International study stated that since the mid-1970s, 'bonded labour has been most notorious in the brick kiln industry. This has grown rapidly in recent decades, with brick kilns springing up in large numbers as towns have expanded'[90] yet, not surprisingly, gives no numbers.

We can conclude this section by re-emphasizing the point that while there is perceived to be a significant problem regarding bonded labour in Pakistan, we certainly do not know enough about either its extent or nature. Only rough guesstimates are available based on some logical premises. Perhaps because there is as yet little investigation and analysis about the issue other than newspaper reports, and also because no agreed definition exists, we have a long way to go before we are in a position to critically assess the situation. Nevertheless, that does not mean that we overlook or ignore the issue, and in the interim, we need to make the best of the tools we have. If the general presence of sharecropping, especially in Sindh, is one of those tools which can help us identify the existence of bonded labour, then one must also say that sharecropping has been on the decline: does this suggest also, that bonded labour is on the decline? Also, the fact that some landlords have had to physically restrain their *haris*/workers and even chain them as they work in the field, suggests that perhaps it is becoming easier for *haris* to escape from their oppressors and find freedom. Since time-series data is not available, one does not know whether bonded labour has increased or fallen. One set of researchers, talking to freed *haris* in Sindh found that the freed *haris* felt that the state of poverty and of bondage had improved more recently compared to the past, and due to greater awareness and the role of human rights groups, better opportunities were opening up. Moreover, if bonded labour is a special, albeit perverse, consequence of sharecropping, one may need to address the issue of sharecropping as much as of bonded labour.

22.8 Can Poverty be Eliminated in Pakistan?

All signs suggest that the answer to this question is an unequivocal 'no'. In the situation which has persisted for the last few years, growth rates are significantly lower than those required to reduce poverty, and are likely to continue to be below such levels for sometime into the future. Public expenditure on development and the social sectors, which has made a nontrivial contribution to poverty reduction, has continued to decline and is less than one-third of what it was in the early and mid-1980s. Experience at targeting and at micro level, focused, poverty alleviating initiatives, does not restore much confidence in the government's ability to address these issues efficiently and effectively, a fact which the government itself concedes, if somewhat reluctantly. With far greater donor dependence and reliance on funding for structural adjustment and stabilization from the IMF

and the World Bank, all indications suggest that the trends which resulted in an increase in poverty and in the worsening of income inequality, are likely to continue and probably be aggravated,[91]—see Boxes 22.5 and 22.9. The one highly positive factor in all this, is the growth in remittances, which is bound to have a very strong positive effect on reducing poverty. However, one must also understand, that remittances are supply-driven, and while they have been very high over the 2009–13 period, there is always a fear that they could also fall. Nevertheless, at the moment, they remain a significant silver lining on the poverty reduction platform.

Even if, in an unlikely event, growth rates do somehow, rise to the perceived poverty reducing level of at least six per cent per annum at some time in the future, and manage to be sustained at that level for some years to come, what cannot be overlooked is that the *given stock of the poor is going to continue to be added to*, making it quite impossible to deal with the huge pool of the poor that emerges. Different assessments estimate that the poor are probably 30–35 per cent of the population, or between 55–65 million individuals. All observers feel that things are going to get far worse if ever they begin to show any signs of improvement, which will result in a rising pool of the poor, both in proportional and absolute terms. In addition, as we show above, according to some estimates, poverty is around 40 per cent of the population, nearly 75 million people, and hence, a further deterioration in the economy will probably result in more being added to the pool of the poor.

Moreover, as a central theme of this chapter argues, it is not *simply* economic growth, even high economic growth, that determines poverty alleviation, but the *nature and distributional impact* of that growth (*pace*, remittances), which has specific poverty alleviating outcomes. It is also important to emphasize that while a number of researchers feel that the decade-long, near 7 per cent growth rates of the 1960s will be sufficient to bring about the conditions for poverty alleviation, the *structural nature of the economy now is radically different from that of five decades ago* and, hence, there are likely to be different outcomes. For example, the role of government in the provision of basic services has diminished considerably since the 1960s and now most services and utilities will have to be bought from the market requiring, perhaps, larger incomes. Also, at a macro level, with a far more closed economy then than now, increases in growth may have been

Box 22.9

Criticism of PRSPs

The most fundamental criticism of Poverty Reduction Strategies relate to the apparent immutability of macroeconomic policy. The 'Washington Consensus', with its emphasis on macroeconomic stability, removal of barriers to international trade, domestic liberalization, privatization and the search for market solutions in the provision of public goods remains intact. Poverty reduction measures continue to be subordinate to these overarching goals. The Strategies are necessary to access IMF/World Bank loans and credits, but the conditions attached to these loans and credits remain largely unchanged (Bretton Woods Project, 2003). This has led to fears that Poverty Reduction Strategies (and particularly interim strategies, developed quickly in order to gain access to credits), are not genuinely country owned, but 'a new form of conditionality imposed by the Bretton Woods Institutions.' (World Health Organization, 2001). These fears are underlined by the reality of the World Bank and IMF teams conducting reviews of Poverty Reduction Strategies, and essentially acting as gatekeepers for access to international assistance (Marcus et al. 2002).

Another key concern expressed has been about the sectoral approach of the Strategies, where measures in social protection, health care and education are often delinked from macroeconomic policies, and little attempt is made to assess the dynamic impact of policies in one sector on outcomes in another. Marcus et al. (2002) argue that in 23 interim and final strategies examined by them, there is little discussion of policies to bring about 'pro-poor' economic growth. There is also little attempt to analyse possible negative impacts of liberalization on certain groups, and how to take compensate for these with social protection and other policies. This orthodox approach is seen by some as disappointing. For example, the World Health Organization argues that the potential of investment in health as a driver of economic growth is not considered in the World Bank's advisory documents for poverty reduction strategies (World Health Organization, 2001).

The above two concerns are closely linked to a third, on the nature of public participation and civil society participation in the production of Poverty Reduction Strategies. There is almost universal agreement that genuine and inclusive consultation is extremely difficult to achieve. This is clearly an important issue for the World Bank itself, which has developed a large literature on participation in public decision-making processes that predates the Poverty Reduction Strategy initiative (see www.worldbank.org/participation). Yet even in advanced industrialized countries, where public consultation is often limited to specific areas of policy and accountability is confined to parliaments, there appear to be few clear models to follow.

The Washington Consensus is not a formal document or agreement, but rather a set of principles that appear to have been informally agreed between the World Bank and the IMF in the late 1980s as a framework for development aid, originally in Latin America, but later in other parts of the world. The principles included: fiscal discipline; redirection of public expenditure priorities towards health, education and infrastructure; tax reform; interest rate liberalization; competitive exchange rate; trade and investment liberalization; privatization, deregulation and secure property rights.

Source: Gerry Redmond, 'Poverty Reduction Strategies and Well-Being in Albania and Former Yugoslavia', Paper presented at Democritus University, Greece, 2003.

consumed/reinvested in the country; now with a far greater import component in the economy, some gains in incomes may be lost to the domestic economy.

Of the 40 per cent of Pakistan's population that lives in rural areas, nearly 35 per cent lives below the poverty line. This means that around 32 million Pakistanis in the rural areas live in poverty. The incidence of rural poverty is highest amongst those who own no land, and over 40 per cent of landless households are poor and together constitute 70 per cent of the rural poor. Clearly, *rural poverty has a critical link with land ownership and access to land.* Without extensive land and agrarian reforms, one cannot even think of alleviating, leave alone reducing, poverty in Pakistan; *land reforms have to be the prime instrument for reducing poverty.* With land reforms not one of the concerns of the government, poverty in Pakistan will persist—See Box 22.10 and Appendix 22.3.

Perhaps the most important feature about poverty alleviation in Pakistan is the absence of hard data and assessments about the extent, nature and distribution of poverty. We actually do not know how poverty is behaving and what directions it is moving in, or the rate of its change. There is great speculation about the size of the poor, but nothing quantifiable as 2013 comes to an end.

22.9 Summary and Further Reading

22.9.1 Summary

This chapter has shown that poverty increased dramatically in Pakistan in the period 1988–2004, with around 50 million Pakistanis living below a subsistence poverty line. While poverty is both an urban and rural phenomenon, the majority of the poor still live in rural areas and face asset—mainly land—deprivation, not owning it or even having access to it. Not only did poverty increase in Pakistan, but so did inequality, with the Gini coefficient being worse than what it was in the 1960s, which was considered by most to be highly inequitable. There are also regional trends which need to be examined independent of national and aggregated statistics, something that is discussed in Chapter 23. However, while there is great debate and disagreement about the possible fall in poverty after around 2003, all indicators suggest that it would have fallen at least till 2008, but must have increased after that. But by how much, we have no idea.

The main argument in this chapter is that poverty rose on account of government policy shifts towards the end of the 1990s. Closely following a Structural Adjustment Programme—although not always its details—the numerous governments since 1988 cut down development expenditure, privatized industry, liberalized trade and the economy and financial markets, all at a pace and in sequence which had a negative bearing on economic growth, and hence, on poverty. Poverty fell, particularly in the 1980s, on account of large remittances, excessive spending in the public sector (i.e. not caring about the fiscal deficit), resulting in high growth. The fall in poverty in the mid-2000s, was on account of higher growth and later, because of increasing remittances, and not because of targeted government interventions. This chapter concludes with the view that poverty is now a permanent phenomenon in Pakistan and might be reduced a little here or there, but is likely to stay. The assumption for this outlook is that growth will not return to the six-plus levels of the 1980s or mid-2000s required for a consistent period to wipe out poverty, and that government interventions in the form of tinkering with the economy with microcredit and other 'safety nets' such as the Benazir Income Support Programme, will not be sufficient to eradicate poverty. The one effective means which could considerably reduce poverty in Pakistan, that of land and agrarian reforms, is an option which no government is willing to seriously consider. With the government accepting yet another IMF programme in September 2013, and with the IMF immediately saying that growth rates will continue to be low, we know that poverty is here to stay.

22.9.2 Further Reading

Perhaps there is no other area of research in Pakistan which has had the funding and exposure as much as Poverty in the recent past. There is a huge amount of literature available on Poverty, not just in Pakistan, but world-wide. In fact, it is correct to say that there is just too much available, looking at poverty from every angle imaginable—poverty and the environment, poverty and trade, poverty and women, and as many themes as one can think of. Moreover, since international financial institutions and donors are so involved in studying, understanding and funding poverty and its alleviation, a large amount of data and information is easily available on the internet. The web sites of the World Bank, Asian Development Bank, IMF, and numerous smaller donors, have links to thousands of studies on poverty. For anyone who is interested in a detailed and serious study on poverty, its theoretical issues, problems with definition and measurement, or any other aspects, these websites are worth many visits and are essential for beginning any enquiry about the state of poverty, and for looking at comparative studies as well.

On Pakistan, most of the references cited in this chapter are easily available and should be consulted. The first place to start should be S. Akbar Zaidi's *An Annotated Bibliography on Poverty in Pakistan* (UNDP, Islamabad, 1999, http://un.org.pk/library/poverty/pov_biblio.htm and http://www.cosspak.org/data/bibliography_on_Poverty_Bibliography_by_S._Akbar_Zaidi.pdf) which has a summary of every single study on poverty undertaken in Pakistan from the 1960s to 1999; it is very useful in terms of an extensive literature review, and since is available on the internet and easily accessible. Two papers by Haris Gazdar are essential to understand the numerous issues related to poverty in Pakistan and are highly recommended: *Review of Pakistan Poverty Data* (Department for International Development, London, 6 April 1998) and the more easily accessible, 'Poverty in Pakistan: A Review', in Shahrukh Rafi Khan's, *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999). A recent comprehensive report by Haris Gazdar looks at issues of both poverty and inequality in Pakistan; see *Policy Responses to Economic Inequality in Pakistan*, Policy Brief 3 (Islamabad: UNDP, April 2009). The 2012 review by the eminent Professor S. M. Naseem, is also essential reading because it is the most

Box 22.10

Poverty Reduction: Two Contrasting Views

This article which appeared in Dawn compares and contrasts two documents of the Government both of which suggest different measures to reduce poverty in Pakistan.

For the last few years, as poverty has continued to persist with about a third of the population living below the poverty line, the Government of Pakistan has become an active proponent of finding ways of alleviating or reducing poverty in the country. In this regard, two official documents—one fully owned by the Ministry of Finance and the other by the Planning Commission—have been made public, yet reveal two very contrasting and indeed, conflicting analyses, opinions and strategies, for poverty reduction in Pakistan.

The Ministry of Finance document is, of course, the Poverty Reduction Strategy Paper (PRSP) still in its draft form, which should be finalized before the end of this year. The PRSP document lays out the poverty alleviation strategy of the government which has been followed since October 1999 and formalizes key elements of that strategy.

The key elements of the PRSP focus on accelerating growth with macroeconomic stability, investing in human capital, expanding social safety nets and emphasize better governance. Private sector growth is seen as one of the most critical elements of Pakistan's poverty reduction strategy, as is the generation of productive employment at a time when the PRSP document acknowledges that the rate of unemployment exceeds 10 per cent in the country. Since the rise in unemployment has been seen largely as a consequence of lower growth, an increase in growth is said to have an employment enhancing effect.

The PRSP document acknowledges that nearly two-thirds of Pakistan's poor live in rural areas and that more than fifty per cent of the rural population is landless. Since poverty in Pakistan has a largely rural dimension, rural development will be needed to help reduce poverty, for which agricultural infrastructure and programmes will be required. There is also a passing reference to the distribution of state owned land to small farmers, though oddly, not to the fifty per cent landless rural population.

While the PRSP claims that it is 'home grown', as do all government policies no matter where they originate from, the other document, the Pakistan Participatory Poverty Assessment (PPA), is in many ways just that, and is a rather different document compared to most other official publications. The PPA is based on in-depth surveys in 51 sites in very poor areas across the country and has had the active involvement and support from the Planning and Development Division of the Federal Government, as well as in each of the provinces and in the Northern Areas and FATA.

Unlike the PRSP, the Participatory Poverty Assessment is based on interviews and opinions of the poor as to why they are poor and how they see their way out of poverty. Hence, unlike the findings of the PRSP, those of the PPA differ markedly.

For a start, one of the main findings of the PPA was regarding the lack of access to land by the poor. The poor want far greater access to land and water and protection of the natural resource base. The concentration of landholdings is found to be impoverishing not just because it means that the poor have few assets on which to depend on, but ultra-exploitation and abuse, a familiar feature of inequitable land distribution in rural Pakistan, is also rampant. Land was seen by the poor as an important source of power, much of it being misused.

The poor, as a consequence, demand access to land as an income earning asset, and access to justice and protection and security so that they can live relatively free lives. Clearly, only with active and extensive land reforms, where land is distributed not just to small farmers but to the landless, and where the power of landlords is broken down, can one hope to see poverty reduced amongst the two-thirds of the poor.

Other findings which show government failure relate to the demand for basic services, especially health care. The poor identified health care related institutions as the most important to them. The poor are far more vulnerable to disease, yet do not have access to government facilities. Moreover, there is a wide gap between what the government is supposed to provide and what poor communities actually receive. The highly inadequate level in investment in basic services was cited as a key reason for the failure of health and education facilities. A crucial requirement to get people out of poverty is to substantially raise public expenditure on services and infrastructure. However, with public expenditure on development falling or not rising in line with need, the condition of the poor regarding access to health, education, water and infrastructure, will probably deteriorate.

The need for jobs was another key need identified by the poor as unemployment is a major cause of poverty. Unfortunately, with lower growth, increased privatization, and an inhospitable economic environment, opportunities for employment continue to stagnate while the number of people looking for jobs grows each year.

The documents reveal very contrasting approaches to the poverty issue in Pakistan. The PRSP strategy of the Ministry of Finance, which is the actual current economic policy of the government, is based primarily on macroeconomic stabilization which does not directly help reduce poverty. Moreover, stabilization has occurred without sufficient growth, a key requirement for poverty reduction. Clearly, the government's current strategy, reflected in the PRSP, is highly insufficient to make a significant dent in the level of poverty in Pakistan.

The PPA document, on the other hand, focuses very sharply on the issue of the access and ownership of land in rural areas where poverty is particularly acute. With the Prime Minister having declared that there will be no more land reforms, poverty in Pakistan is here to stay, and all other attempts at poverty reduction or alleviation, are likely to remain far from adequate. If there is any sincerity in the government's desire to reduce poverty, it will have to push land reforms to the top of its poverty reduction strategy. There is no other alternative.

Source: S. Akbar Zaidi, *Dawn*, September 13, 2003.

recent but also because of the issues it discusses and for the most recent bibliography on poverty in Pakistan: Naseem, S. M., *A Review of Studies on Poverty in Pakistan: Origin, Evolution, Thematic Content and Future Directions*, History of PIDE Series-6 (Islamabad: Pakistan Institute of Development Economics, 2012).

The Mahbub ul Haq Centre for Human Development's *A Profile of Poverty in Pakistan* (Islamabad, February 1999) has numerous articles as are the Annual Reviews of the Social Policy Development Centre (SPDC), particularly their *Annual Review 2000: Towards Poverty Reduction* (Karachi: Oxford University Press, 2001) and *Annual Review 2001: Growth, Inequality and Poverty* (Karachi: Oxford University Press, 2002). It is not possible to look at the phenomenon of poverty in Pakistan and not consult the World Bank's studies on poverty: their two reports are essential reading as well. See World Bank, *Pakistan Poverty Assessment*, Report No 14397-PAK (Washington DC: World Bank, 1995), and the more recent World Bank, *Pakistan Poverty Assessment*, Report No. 24296-PAK (Washington DC: World Bank, October 2002). Akmal Hussain's, *Pakistan: National Human Development Report 2003* (Islamabad: UNDP, 2003) is also recommended. The Reports of the Centre for Research on Poverty Reduction and Income Distribution (CRPRID): Annual Reports on the Millennium Development Goals. For material on bonded labour, see Aly Ercelawn and Muhammad Nauman, *Bonded Labour in Pakistan*, Working Paper/1/2001 (Geneva: ILO, 2001).

For a very different understanding of poverty in Pakistan, the Pakistan Participatory Poverty Assessments (PPA) are recommended, as the national and seven Pakistan regional reports, are based on the 'Voices of the Poor', where detailed qualitative stories and reports from the poor themselves, have been documented. These have been published by the Planning Commission in Islamabad. The Ministry of Finance's *Poverty Reduction Strategy Paper* (PRSP), released in early 2004, should also be consulted as it describes the Government's poverty reduction strategy—also see Box 22.8.

PRSPs have now become important documents used by the IMF and the World Bank in dealing with developing countries. A great deal of information about PRSPs is available on the web pages of these organizations. In addition, the following references would be very useful: Bretton Woods Project, *Poverty Reduction Strategy Papers (PRSPs): A Rough Guide*, Bretton Woods Project (London, 2003) *www.brettonwoodsproject.org*; R. Marcus et al. 'Poverty Reduction Strategy Papers (PRSPs)—fulfilling their potential for children in poverty?', *Journal of International Development*, vol. 14, 2002, 1117–28; and, World Health Organization, *Health in PRSPs: WHO Submission to the World Bank/IMF Review of PRSPs*, December 2001, *www.worldbank.org/poverty/strategies/review*.

Since there have been data constraint regarding poverty numbers in Pakistan since 2006/7, as well as much controversy, there has been little new research on the nature of poverty in Pakistan after 2006/7. However, the contribution by Haroon Jamal of the Social Policy and Development Centre (SPDC), Karachi, stands out in this regard. Most of his papers are available on the SPDC web site and should be consulted.

Appendix 22.1

Estimating Poverty Lines

This extract from Haris Gazdar's excellent article 'Poverty in Pakistan: A Review', shows the problems in the measurement and qualification of poverty lines. Anyone, interested in poverty in Pakistan is advised to read the full article.

I. The Construction of Poverty Lines

Most empirical work on poverty in Pakistan has been carried out with reference to a poverty line or a set of poverty lines. One of the most popular approaches has been to define poverty in terms of the ability of a household or individual to attain a certain level of calorie intake. However although 'fixing' a unique poverty line may have some merit in the political economy of public policy, it is of limited use as an analytical construct, and does not add very much to the conduct of poverty analysis. A more eclectic approach that involves using a range of poverty lines and focuses on relative poverty rankings of different population groups can be more informative of the nature of income-and consumption-poverty. Arguments about the construction of poverty lines cannot be ignored entirely, however, since much of the applied work on poverty analysis in Pakistan has been concerned first and foremost with these issues. Moreover, barring a few exceptions, all applied poverty analysis takes caloric standards as the starting point.

The basic idea behind the caloric approaches is that the poverty line (in the income or consumption spaces) needs to be set with reference to minimum recommended standards of calorie intake. It is assumed that there is a stable functional relationship between income or consumption and calorie intake. The recommended caloric requirements for healthy living are derived from clinical nutritional tests under controlled conditions. The poverty line is simply that level of income or total consumption expenditure which is consistent with achieving the recommended daily intake of calories. The popularity of the calorie-based approach rests on its apparent scientificity, and the ease of interpretation. Neither of these two suppositions, however, turns out to be durable under scrutiny.

While it is true that clinical nutritional tests lie behind the recommended calorie standards, on which poverty lines are then based, the interpretation of these norms as immutable basic requirements is open to question. Nutritional tests are carried out for controlled groups of subjects and under controlled conditions of physical exertion. There is a great deal of interpersonal variation in calorie requirements, as

well as a great deal of variation in the calorie requirements of a person under different circumstances. The poverty line, however, is a summary benchmark indicator, and poverty analysis is usually carried out using data sources that are unable to provide detailed information about a person's precise physiological condition or quantify her normal level of physical exertion. The possibility of wide inter-personal and inter-temporal variations in minimum caloric requirements is further complicated by the fact that there is no consensus among poverty analysts on which caloric norm to use for constructing poverty lines. Operationally, the norms that have been used vary between 2,000 to 2,550 kcal per day—a range of over 20 per cent. Even the apparently simple task of assigning minimum calorie norms on the basis of physiological testing rests to a great extent on the exercise of choice and judgement on the part of the analyst.

The mapping of caloric norms onto household incomes or consumption presents another set of problems. The most common method in this regard is based upon the estimation of a calorie-expenditure function. The relationship between total income or expenditure and caloric intake is estimated statistically using household budget survey data, which typically include information on the quantities of various food items consumed. The poverty line is then set as that income or expenditure level at which the expected calorie consumption (based on parameter estimates) is just equal to the recommended caloric norm. Recent users of this approach in Pakistan have been Ercelawn (1991) and Malik (1991, 1994). A variation on this approach was suggested by Lanjouw (1994) where the consumption patterns of the poorest groups were used rather than those of the entire sample as in Ercelawn (1991) and Malik (1991, 1994). The basic idea here is that the consumption patterns in the sample itself are used to determine the level of total expenditure which is consistent with achieving the caloric norms.

Calorie consumption depends, however, on a whole range of variables and not simply on household purchasing power. For any given level of income, for example, a household whose members are involved in relatively arduous physical labour is likely have a higher consumption of calories compared to a similar household whose members have relatively sedentary work or leisure activities. A poverty line which is based upon the statistical relationship between calorie consumption and household expenditure is a rough average over households made of individuals of very differing physiologies and with very different rates of expending energy. To interpret such a poverty line as marking off potentially well-nourished individuals from potentially malnourished ones would require extremely stringent and untenable assumptions about the distribution of these other attributes.

Even seemingly 'objective' ways of arriving at poverty lines, therefore, are fraught with a large number of 'subjective' choices and decisions such as: which caloric norm to use? Whether to set the poverty lines according to the consumption pattern of the entire sample or a subset of it? And, how precisely to map calories to expenditure or income?

As noted above, there are few exceptions to calorie-based approaches to the construction of poverty lines. These exceptions (including Gazdar, Howes and Zaidi, 1994 and Ahmad, 1993) are based on the argument that the poverty line could be interpreted as a 'minimum' or 'basic' needs consumption bundle. The precise composition and value of the basic needs bundle depends on the specific economic and social context under consideration. One way of thinking about the poverty line is that it represents the minimum level of income or consumption below which a person ought to be regarded as socially disadvantaged. Ahmad (1993) arrives at this minimal bundle on the basis of a consultative exercise involving not only policymakers but also members of the public. His results were used by Gazdar, Howes and Zaidi, 1994a.

These approaches have been criticized on the grounds that they are arbitrary and 'subjective' (Ali, 1995). This criticism reveals some confusion about the status of methods such as consultative exercises and opinion surveys. The main difference between such methods and statistical methods that estimate parameters from survey data is that the latter are based upon revealed behaviour while the former are based on express evaluations of social status. Surveys that collect data on opinions about social status are neither more nor less subjective than those which collect data on actual consumption. They are, in fact, attempting to answer different questions.

Any particular method for the derivation of a poverty line involves a number of choices and judgements that need to be made by the analyst or the policymaker. The quest of a 'pure' scientific or 'objective' poverty line, therefore, is likely to remain unfulfilled. Rather than expend further intellectual resources in this quest, it would be better if researchers chose from existing poverty lines in order to take analysis further, or worked with a range of poverty lines without worrying to much about their pedigree.

The contrast between poverty analysis in India and Pakistan is quite interesting in this regard. The original rural poverty line in India was, indeed, referenced around a daily intake of 2,100 calories per person, while the urban line was based originally on 1,900 calories per day. This was done for 1960-61 in an influential study by Dandekar and Rath (1971). The difference between the rural and urban caloric norms was explained in terms of the higher energy needs of the rural population due to their more physically exacting work and lifestyles, but no reasons were given for the precise difference of 200 calories per day between the two groups. In the subsequent updating and adjustment of the Indian poverty line, however, the reference to calorie standards was dropped and standard price indices were used. Although the poverty line in use currently is based on one that was first estimated with calorific standards in mind, no attempt has been made to refer the subsequent updating of this poverty line to calorific standards.

While in India much of the discussion has revolved around the methodology for updating an agreed benchmark poverty line over time and for regions, rather than on defining that benchmark, in Pakistan, a great deal of work in the measurement of poverty deals with the specification of the benchmark. The most likely explanation for the general acceptance in India of one benchmark poverty line and the lack of consensus on this issue in Pakistan is that in India the government officially endorsed the poverty line. In Pakistan,

despite a number of attempts by various bodies, no official poverty line has yet been endorsed.

For purposes of research into poverty, as well as for policy matters, the precise origin of a poverty line does not really matter, since any poverty line would be based at least partly on normative criteria, and thus there is some measure of arbitrariness in its choice. What is important is not how the initial poverty line was specified in the first place, but the methods which are used for updating it over time, across regions, and for rural and urban areas. For such analysis, in fact, it is better to use not one but a set of poverty lines.

II. Inter-Regional and Inter-Temporal Adjustments

The issue of adjusting a benchmark poverty line for different regions and over time—even a poverty line that might have been chosen completely arbitrarily in the first place—is an important one. There is a case, of course, for updating the initial bundle from time to time in order to reflect long-term changes in the economy and in consumption patterns. The poverty line is, after all, to a great extent, socially constructed. In other words, the socially acceptable minimum standard of living can and does change as economic conditions change. Updating the poverty line for medium-to long-term changes in economic conditions, individual preferences and social norms, however is not the same as adjusting the poverty line to account for changes in the cost of living over time, or to account for differences in the cost of living between different regions.

If the poverty line is regarded as the value of a minimum bundle, the appropriate method for adjusting it for different regions and for different time periods is the same as the method for making such adjustments for any other value that is expressed in money terms—i.e. a price index. The main issue is to find the appropriate adjustment factors for differences in the cost of living (or the cost of acquiring that bundle), and applying these adjustment factors to the benchmark poverty line.

While there is a fair degree of agreement over this method, some practitioners, particularly those who have favoured calorie based approaches to the construction of the poverty line, have taken a different route. Ercelawn (1991), for example, estimated separate calorie-expenditure functions for each province and indeed, for cities, towns and rural areas respectively within each province. Malik (1991, 1994) conducted a similar exercise with the rural sample, and simply used the poverty line then obtained for the entire sample. This method requires a brief comment, because it is popular among some poverty analysis and because its use is premised on the unfounded presumption of scientific objectivity.

The problems with interpreting any calorie-based poverty line as marking off actual or potential malnourished households or individuals from the rest were discussed above. Using estimates of separate calorie-consumption functions in order to make regional and temporal adjustments to the benchmark poverty line is fraught with even greater difficulties. One serious problem has been encountered in the separate estimation of calorie consumption functions in rural and urban areas, and the use of a unique caloric norm for the type of area. If the rural sample includes a much higher concentration of workers involved in physically demanding labour (as is, indeed, plausible) and if the rural lifestyle, in general, requires a greater consumption of calories than the urban lifestyle (due to the need to walk longer distances to fetch water, for example), then for any given level of income, the rural households are likely to consume more calories, on average, than their urban counterparts. Estimating the poverty line from a calorie-expenditure function using a unique caloric standard for the urban and rural sub-samples would have the effect of over-estimating the urban poverty line in comparison with the rural.

One way around much estimation biases has been to designate different caloric standards for urban and rural areas. It is not clear, however, as to what the precise difference between the caloric standards for urban and rural areas ought to be. Often the difference is based on a judgement on the part of the analyst in order to produce plausible rural and urban estimates of relative poverty. In the case of poverty line adjustments also, therefore, the calorific approach has the appearance of 'objectivity' while relying, ultimately, on reasonable but subjective judgement in order to arrive at results that are plausible.

Source: Gazdar, Haris, 'Poverty in Pakistan: A Review', in Khan, Shahrukh (ed.), *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999), 265–274.

Appendix 22.2

The Political Economy of Number Crunching: Poverty Data in Pakistan

In a number of articles on poverty estimates in Pakistan, Ashfaque H. Khan, a senior economist and prominent member of the Musharraf-Shaukat Aziz economic team, has given a comprehensive and detailed assessment of the political economy issues of estimating poverty in Pakistan. The following short pieces, partially edited, from him between 2009 and 2012, reveal many of the issues which have been in the public eye since the Pakistan People's Party government took office in 2008. For a response and critique, we also add an article by Pervez Tahir, Pakistan's former Chief Economist.

1. The present government is facing real embarrassment on poverty estimates for 2007-08. The Panel of Economists, formed by the government in April 2008 under the leadership of Dr Hafiz Pasha, found that 35-40 per cent people of

Pakistan were living below the poverty line in 2007-08—up from 22.3 per cent in 2005-06. The political leadership, unaware of the technical details of the estimation techniques, took the estimates of the Panel seriously and everybody, including the ministers, the prime minister and the president started mentioning the numbers within and outside the country. The political leadership had no reason to distrust the professional skills of the Panel of Economists. Their only fault was that they could not realise that some members of the Panel of Economists were positioning themselves to get ministerial jobs and some retired "experts" were trying to secure their jobs in the government. These people could have moved their way to the present regime only if they would paint a bleak picture of the state of the economy, including the substantial rise in poverty. I am positive that this Panel of Economists has had no courage to write similar three paragraphs as documented in the Memorandum of Economic and Financial Policies attached with the Letter of Intent, signed by the Government of Pakistan on Nov 20, 2008 with the IMF. These three paragraphs, written by the present regime, very aptly summarize the major economic and social achievements of the last one decade, including the 'reduction in poverty and an improvement in many social indicators'. It appears that the Panel of Economists was trying to become more Christian than the Pope and as such came up with poverty estimates based on flawed methodology.

On the other hand, the Centre for Poverty Reduction and Social Policy Development (CPRSPD), using the PSLM Survey 2007-08, also estimated poverty for the year 2007-08. They found that poverty at national level declined sharply from 22.3 per cent in 2005-06 to 17.2 per cent in 2007-08. Poverty, both in rural and urban areas also registered sharp declines. The estimates of the CPRSPD were also validated by the experts from the World Bank. The 'experts' from the Planning Commission are of the view that a sharp decline in poverty in 2007-08 does not depict the ground reality. Why should it depict the ground reality? Firstly, the period it covers is from July 2007 to June 2008. Secondly, poverty estimates are not like the growth number, money supply or inflation which change yearly. Poverty number reflects the changes in the lives of the people which are affected by the policies pursued for a fairly long period of time. To be fair to the government, how can they say now that the poverty in Pakistan has declined substantially in 2007-08 as opposed to their earlier stance that it had increased to the range of 35-40 per cent? In other words, how can they say that at the time of taking charge of the state of affairs only 17.2 per cent people were living below the poverty line and that there are indications that poverty is on the rise once again in Pakistan. This is indeed the real embarrassment for the government caused by the Panel of Economists.

Poverty estimates are highly sensitive to changes in different variables. For example, should we use calorie intake or basic need approach or should we use 2550, 2250 or 2350 calorie to draw the poverty line? Should we use CPI, SPI, WPI or prices derived from the Survey itself to adjust the poverty line or should we use consumption or income? The basket of commodities may differ across researchers and even the cleaning protocol of data may give different poverty estimates. Thus, at any given point in time there can be different poverty estimates with same or different data sets. What is required, therefore, is that we continue to use the same methodology irrespective of its strength and weaknesses, lest we should never be able to know as to what is happening on poverty front.

There are views about the methodology used by the Panel of Economists. One, that in the absence of PSLM Survey data for 2007-08 the Panel simply adjusted the poverty line upward to the extent of cumulative inflation (20 per cent) for the period 2006-07 and 2007-08. On the other hand, they used household consumption expenditure for the year 2005-06, which was not adjusted upward to match the poverty line. In other words, apple was compared with orange. Naturally, such a flawed methodology was bound to produce erroneous results. Second, that the Panel used an equation to forecast poverty. This equation has many exogenous variables, such as food inflation, remittances, openness of trade, development expenditure as percentage of GDP, etc. Giving the value of each variable for 2007-08 and using the estimated parameters it predicted poverty for 2007-08. Forecasting is a complex exercise and requires transparency in the use of data. The Panel did not release those numbers which went into the model. Thirdly, they used the preliminary version of the model whose parameters changed substantially in subsequent revisions. The Panel never bothered to contact the author of the model. Had they contacted him, he could have saved the Panel from such disgrace.

Source: Khan, Ashfaque H., 'On Poverty Estimates', *The News*, Karachi, 7 July 2009.

11. The Centre for Poverty Reduction and Social Policy Development (CPRSPD) of the Planning Commission has estimated the extent of poverty in Pakistan by using the Pakistan Social and Living Standards Measurement Survey, commonly known as the PSLM Survey, for the year 2007-08. The CPRSPD found a sharp decline in nation-wide poverty in 2007-08 over 2005-06. It found that the number of people living below the poverty line declined from 22.3 per cent in 2005-06 to 17.2 per cent in 2007-08. Rural and urban poverty also registered declines from 27 to 20.6 per cent and 13.1 to 10.1 per cent, respectively during the period. These results were also validated by the World Bank experts, Mr Nobu Yoshida and Tomayuki Sho, especially flown from the World Bank headquarters at the request of the government of Pakistan. These two experts conducted their validation exercise and presented their results to the Planning Commission on 29 May 2009. The World Bank experts recommended that the government should release these numbers because these are credible.

Despite the World Bank's recommendation, the government has not yet released the poverty numbers. Why is it so reluctant in releasing the poverty numbers? To answer this question, I will have to remind the readers that immediately after taking charge of the state of affairs the present government had

formed a Panel of Economists headed by Dr Hafiz Pasha in April 2008. The panel found that 35-40 per cent of the population was living below the poverty line in 2007-08—up from 22.3 per cent in 2005-06. It is important to note that when the panel was working on poverty estimates, the PSLM Survey data for 2007-08 was not available. They estimated the numbers using some methodology which was never revealed by them. It is now exceedingly clear that the estimates were based on flawed methodology. I had objected to the use of such methodology because I was then associated with the ministry of finance. The visiting World Bank team at that time was also of the same opinion.

The political leadership, unaware of the technical details, took the estimates of the panel seriously and everybody, including the president, the prime minister, and the cabinet ministers started mentioning the numbers within and outside the country. Even the same numbers as estimated by the panel appeared in the document of the Friends of Democratic Pakistan (FODP) meeting held in Tokyo last year. The political leadership had no reason to distrust the professional skills of the economists in the panel. However, their only fault was that they could not realise that some members of the panel were positioning themselves to get lucrative assignments and some retired 'experts' were trying to secure their jobs in the government.

How could the government release the poverty numbers of the CPRSPD? How could it comply with the recommendations of the World Bank to release the numbers? The CPRSPD found a sharp decline in poverty, which was validated by the World Bank. The panel under the leadership of Dr Hafiz Pasha on the other hand found a sharp increase in poverty. This is a real embarrassment for the government. How could it tell the world in general and people of Pakistan in particular that poverty numbers which they were propagating were wrong and based on flawed methodology? I have all the sympathy with the political leadership.

The question generally being raised by some stubborn 'experts' that the poverty numbers estimated by the CPRSPD and validated by the World Bank do not represent the current ground reality. How could this be the representative of the current ground reality when the survey itself was conducted from July 2007 to June 2008? The current ground reality will be reflected when the PSLM survey for 2010-11, if at all, will be conducted.

Not releasing the numbers has wide-ranging consequences. First, the benchmark for the poverty numbers is five years old (2005-06). Second, the next PSLM survey which was to be conducted in 2009-10 has been delayed. Third, the government is trying to conduct a fresh survey which is not in line with the PSLM methodology. This is tantamount to moving the goalpost and destroying the poverty numbers.

. . . Poverty may have increased in Pakistan after 2007-08. The global economic crisis in 2008 has brought miseries for the people of Asia-Pacific region. More than 26 million people could lose jobs by the end of 2010; and millions who took decades to work their way out of poverty have slipped back in it. Pakistan is part of the region and is no exception. Rise in poverty is a global phenomenon and we should not be apologetic on this count. The panel has not only embarrassed the government but has also brought a bad name for the country. It is in the interest of Dr Shaikh and in the interest of the country that such "experts" are kept outside the Q-block.

Source: Khan, Ashfaque H., 'On Releasing Poverty Numbers, *The News*, Karachi, 13 April 2009.

III. Mehtab Haider, a well-respected economic journalist of The News, published a story headlined 'Poverty reduced to half in Musharraf's regime: WB Report' (7 August). Quoting from the World Bank's 30 July report, 'Country Partnership Strategy', the writer, Mehtab Haider, reported that the percentage of Pakistanis living the below poverty line had fallen from 34.5 per cent in 2001-02 to 17.2 per cent in 2007-08.

This news item has vindicated my position, thanks to the World Bank. I had been urging the government over the last 15 months through my columns to release the poverty numbers for 2007-08. The government, in particular the Planning Commission, failed to release the numbers, obviously for political reasons.

. . . Why is the government so reluctant in releasing the poverty figures? There are two reasons for this. First, as Mehtab Haider has said 'poverty reduced to half in Musharraf's regime . . .'. The government wanted to suppress the figures because it never wanted to tell the people that they inherited only 17.2 per cent people living below the poverty line. Furthermore, it was politically suicidal to admit that poverty reduced to one-half in just six years during 'Musharraf's regime'.

Secondly, the government had formed a "Panel of Economists" headed by Dr Hafiz A. Pasha in April 2008. The panel found that 35-40 per cent of the population was living below poverty line in 2007-08-up from 22.3 per cent in 2005-06. It is important to note that when the panel was working on poverty estimates, the PSLM Survey data for 2007-08 were not available. The panel estimated the numbers under a methodology that was never revealed. It is now exceedingly clear that the panel's estimates were based on flawed methodology.

Some professional economists like to put themselves into potentially advantageous position whenever a change of government takes place in Pakistan. Some retired 'experts' would do anything to please the new political leadership to protect their jobs. Some would try to secure lucrative jobs or consultancy positions. Jobs and consultancies would be available only if they painted a horrible picture of the state of the economy inherited by the new leadership. A combination of all these motives was enough to persuade the political leadership to prevent the release of the poverty figures.

Even a cursory look at these figures would reveal that not only poverty declined sharply in Pakistan from 2001-02 to 2007-08 but inequality was reduced as well. Meanwhile, social indicators improved and the unemployment rate dropped. Are such outcomes not the cherished goals of every government? If something good happened from 2001-02 to 2007-08, there is nothing wrong in acknowledging the facts.

Should the government still not release the poverty numbers even after the World Bank has done so? Where are those so

called 'experts' in the Planning Commission now? Where are the members or the head of the Panel of Economists? Wouldn't they advise the Planning Commission to release the numbers now? Or would they continue to live in a state of denial? Suppressing the figures, thereby misguiding the people of Pakistan, is highly deplorable.

Source: Khan, Ashfaque H., 'Concealed for 15 Months', *The News*, Karachi, 10 August 2010.

IV. Dr Nadeem-ul-Haque, the Deputy Chairman of the Planning Commission, while talking to leading economic journalists Mehtab Haider and Shahbaz Rana representing two English dailies, made highly irresponsible statements, which were not at all consistent with his stature.

While giving justifications for not releasing the poverty numbers, the deputy chairman said: '. . . the figure of 17.2 per cent as given by the Musharraf regime on the basis of the survey carried out in 2007–08 was a total "fraud".' When it was pointed out to him that the World Bank and the UNDP had endorsed the number of 17.2 per cent, the deputy chairman insisted that it was 'contrary to the ground realities'.

No sensible government official should make such an irresponsible statement. By terming the poverty estimate of 17.2 per cent as total 'fraud', he has not only insulted two international institutions, namely the World Bank and the UNDP, but also insulted dozens of experts of these institutions as well as the young and bright economists of the Centre for Poverty Reduction and Social Policy Development (CPRSPD).

Let me ask the deputy chairman: were Nobu Yoshida and Tomayuki Sho, poverty experts of the South Asian Department of the World Bank, frauds? Was Professor Nanak Kakwani—an authority on poverty measurements and an expert of the UNDP—a fraud? Were the young economists of the CPRSPD who have been estimating poverty since 2004–05 frauds as well? This is the height of arrogance.

Since the deputy chairman has lived outside the country for decades and, as such, is oblivious to the many developments that have taken place in the country, I would like to update him as well as others on poverty estimates in Pakistan. [The arguments presented in this particular newspaper article were similar to those presented in earlier ones so are not being repeated here. SAZ]

. . . These results were presented to the planning commission in March 2009—one year after the new government took charge of state of affairs. It should, therefore, be clear to the deputy chairman that these numbers were not given by the Musharraf regime (how ignorant is he about this fact!).

. . . The deputy chairman calls this a total fraud. Isn't he insulting the World Bank and its experts? Isn't this an irresponsible statement? By calling this a total fraud, he has also insulted the experts of the UNDP, Professor Nanak Kakwani. In 2004–05, the UNDP brought in Professor Nanak Kakwani from Brazil to assist the young economists at the CPRSPD in estimating poverty. He reviewed methodology and estimation technique and estimated poverty for the years 2001–02 and 2004–05.

The young economists of the CPRSPD estimated poverty for the year 2005–06 which was validated both by the World Bank and the UNDP. They did the same for 2007–08, and the estimates were again validated by the World Bank. Instead of appreciating their work and releasing the numbers, the government victimised them to the extent that their mandate to estimate poverty was taken away. Not only that, the poverty centre has now been converted into Inclusive Growth Centre with the mandate to concentrate on economic growth only.

The deputy chairman believes that higher economic growth on a sustained basis is the best available way to tackle poverty. No one would disagree with him, but how would we know that higher economic growth has reduced poverty unless we have benchmark poverty estimates?

I would urge the deputy chairman to apologise to the World Bank, the UNDP and the CPRSPD economists for his statement. Short of asking the World Bank to withdraw its report containing poverty numbers for 2007–08, the gentleman has little choice but to face reality in making his statements

Source: Khan, Ashfaque H., 'Poverty Estimates', *The News*, Karachi, 11 October 2011.

V. Pervez Tahir offers a different explanation on the issue, and critiques the likes of Ashfaque H. Khan.

A debate is raging on why the government has not released the poverty number estimated for 2007–08. In fact, the government has not formally owned any number since the controversial number related to 2004–05. The Musharraf boys who masterminded the 'Operation Reduce Poverty' by hook or by crook are quite keen, just before the looming elections, to show that the Millennium Development Goal to halve poverty had vey nearly been achieved in his last year.

What they are focusing on, however, is methodology of estimation and not the data corrupted by them to achieve the results they wanted. Any one using this data and the official methodology will get the same result. This is what is meant by the validation exercises being quoted ad nauseum. Thus, when independent experts and organizations like the World Bank are asked to validate, they are not validating the data. It is simply beyond them, unless they have the resources to re-run the entire survey.

The World Bank validation report of 30 May 2008 quoted by the apologists says, 'The World Bank team endorses the CPRSPD/Planning Commission's estimates for 2005-06. The team found that CPRSPD/Planning Commission's poverty estimates for 2005–06 followed the official methodology accurately . . .'. As can be seen, there is no comment on the data itself.

Poverty politics had started from the very beginning of the Musharraf takeover. The Household Integrated Economic Survey (HIES) 2000–01 had been conducted by the federal bureau of statistics, but its release and analysis was not allowed for quite some time. It was a period of severe drought, signalling a rise in poverty. This would not have been liked by a government looking for legitimacy in economic improvement.

Much depended on where the poverty line was drawn. It was notified in great haste on 23 July 2002 by Mutawakkil Kazi, the handpicked planning secretary. (His pearls of wisdom: 'At no time ever in history has there been a better orchestrated comprehensive poverty reduction strategy than the one under implementation now.') The notification was issued without the knowledge of the chief economist. It was withdrawn after the later protested, and a revised version issued on 16 August 2002.

On the basis of 1998-99 data, the official poverty line was determined at 2350 calorie per adult equivalent per day, requiring Rs. 673.54 for their provision in 1998-99. The notification also announced a headcount poverty ratio of 30.6 per cent. Both the poverty line and the number based on it were estimated by the federal bureau of statistics, not planning commission.

It was in 2003 that the planning commission's poverty centre was able to estimate poverty line and the poverty number for the 2000-01 data. The poverty line was estimated at Rs. 748.56 and the poverty count at 32.13 per cent of the population. It still understated poverty compared to estimates by donor agencies. However, the finance minister and his economic adviser were not pleased with the rise of poverty by 1.53 percentage points since the usurpation of power by their commando boss, who had been advised that poverty was under control. The economic adviser, who survived seven finance ministers despite being on contract, went all out to discredit the result. A recall survey was ordered two years after the main survey. Such exercises are carried out within months so that the respondents can fairly recall what they said earlier. No one took it seriously.

But the Musharraf boys took the next survey, due in 2004-05, more than seriously. The finance minister had now become the prime minister for the 'wonders' that he had performed for the economy—except of course for poverty. Something had to be done. The orders went out to change the governance of the federal bureau of statistics to nip the evil in the bud, i.e. to start with the management of the survey, i.e. itself.

The standard recipe of appointing an additional secretary in charge willing to do anything to become secretary was applied. He ran the statistics division like a section officer and assumed the charge of the director general of federal bureau of statistics himself. An extremely capable officer of the bureau, rightfully expecting to be the head of the organization, was shown the door. No wonder, the economic adviser himself was seen burning midnight's oil in the computer centre of the bureau. The data was not given to the Planning Commission until the statistical saboteurs were satisfied that the expenditure tables suited their targeted outcome.

Compared to the drought year of 2000-01, poverty had to decline in 2004-05 that was a year of good crops and high growth (How high, of course, is another story). A reversal of the rising trend would be achievement enough. When the data was analysed in the poverty centre of the planning commission, the results showed a high reduction of around 5 percentage points. An annual reduction of one percentage point was high—and incredible.

The midnight jackals seemed to have achieved their objectives. They could have now claimed that the military government had not only turned the economy around, but it had also achieved a major reduction in poverty ratio. This was, however, not considered enough and the witch doctors went for an overkill.

Their creativity went beyond fitting the data to their objectives. For 2000-01, the poverty line of Rs. 748.56 was derived from the survey conducted for the assessment of poverty itself. This survey covers rural areas and its consumption expenditure data has embedded in it the prices faced by the rural as well as urban respondents. Obviously, this is a preferred way of depicting the real poverty line faced in Pakistan.

Instead of using the same procedure for 2004-05, the apologists of military regime pressurised the economists and statisticians in the poverty centre to present an alternative estimate in terms of the Consumer Price Index (CPI). The problem with our CPI is that it does not cover rural areas. With the large bulk of the poor struggling to eke out an existence in the rural economy, the use of CPI does not make sense.

According to this exercise in cynicism, the poverty line for 2000-01 was reduced retrospectively. As a result, the poverty number in that year increased from 32.13 per cent to 34.46 per cent. Ironically, these very apologists who were unhappy with the original figure of 32.13 per cent and had challenged it on the basis of an illegitimate recall survey were now more than willing to jack it up. Not for nothing, though. The use of CPI had also reduced the poverty count by a significant margin for 2004-05. A higher base figure in 2000-01 would further increase the rate of poverty reduction. Actually, it doubled to an annual reduction of over two percentage points—the highest ever rate of poverty reduction known to economic history.

A committee under planning secretary was set up to determine which estimate to present officially. It included, among others, veteran economic journalist M. Aftab and John Wall of the World Bank. What the World Bank had to say in the meeting was printed in an article by John Wall in The News. The World Bank presented its own estimate based on the survey prices, which came close to the survey-based estimate of the poverty centre. But it avoided taking any sides. It is incorrect to say that the 'development partners validated the poverty numbers'. M. Aftab can tell the rest of the story. Basically, the committee did not come up with a definite recommendation.

The Annual Plan Coordination Committee meeting in 2006 was the forum where the chief economist would have given the official number. In the absence of any decision by the afore-said committee, this would be the survey based figure of 27 per cent for 2004-05 compared to 32.1 in 2001-02. He was not allowed to present these figures. Earlier, these figures had been presented in the mid-year meeting of the National Economic Council by the deputy chairman of the planning commission.

The chief economist had doubts about even these figures, based as they were on a questionable dataset, but he was willing to go along to avoid the completely unrealistic alternative based on CPI. The deputy chairman wanted to show better performance but not without being reassured by professional opinion. The only 'professional' opinion available

in support of the CPI based estimate was that of the master fixer of the poverty survey, who also had the ear of the prime minister.

While the chief economist was in Sri Lanka as a member of the delegation led by social welfare minister Zubeida Jalal to a World Bank meeting on social protection, the CPI-based estimate was adopted officially at the level of the prime minister. The chief economist was not only removed from his position, he was punished by posting him to a position meant for Grade 20 officers, despite being a very senior Grade 22 officer. In his column, Munoo Bhai had written that though the name was Pervez, and the sacking was also during a tour in Sri Lanka, his misfortune was that he was not wearing a uniform.

Poverty reduction never looked back since. From 34.46 per cent in 2000–01, it fell to 23.9 per cent in 2004–05. In 2005–06, poverty declined to 22.3 per cent and within the next two years, the decline again picked up pace and the poverty ratio was estimated to be as low as 17.2 per cent in 2007–08. Elsewhere, I have described the present economic team as an economic team consisting of three marketeers. Mercifully, however, it has not yet indulged in the doctoring of 'ground realities'—the uninterrupted comparative advantage of the Musharraf boys.

Source: Tahir, Pervez, 'Politics of Poverty', *The News on Sunday*, Karachi, 30 October 2011.

Appendix 22.3

Alleviating Poverty

This extract from the 2001 Annual Review of the Social Policy and Development Centre presents an interesting view of how interventions in the economy can help alleviate poverty.

Poverty reduction is a function of growth as well as welfare transfers through social policy.

The analysis of macroeconomic policy has illustrated the fact that the thrust of policy since 1988 has been to pursue stabilization objectives at the cost of growth objectives. The mechanism for this policy has been a contractionary fiscal policy, centred largely on cuts in development expenditure. The policy has been counter-productive, dampening investment, curtailing purchasing power and leading to a recessionary situation.

The burden of economic adjustments has fallen largely on the poor and has contributed directly to the increase in unemployment and poverty. Today, 6.5 per cent of the labour force is unemployed and 38 per cent of the population subsists below the poverty line. Over the last three years alone, 350,000 people have been rendered unemployed and 7 million have been pushed below the poverty line. The brunt of increased poverty has been borne by the lowest income groups and has intensified inequality. It is shown that while the income share of the top 20 per cent of households grew from 44 per cent in 1988 to 50 per cent in 1998, the share of the lowest 20 per cent of households declined from 9 per cent to 7 per cent over the same period.

Clearly, this situation is not tenable. A fundamental shift in policy is called for. The principal target should be growth, with stabilization as an accompanying objective. There is an urgent need for the focus of fiscal policy to shift from revenue mobilization to current expenditure reduction, with substantial enhancement in development expenditure. This is essential in order to create the crowd-in effect for investment and for growth in employment, income and purchasing power. Ultimately, this will ensure that poverty is reduced in absolute terms. The contractionary fiscal policy regime needs to be relaxed. The preoccupation with curtailing fiscal deficits also needs to be reviewed. Fiscal deficits can be positively employed if the amounts thus generated are devoted to investment in productivity, enhancing infrastructure and employment generating projects.

A shift is also called for in development priorities from capital intensive mega-projects to high value-added projects that would generate a stream of income and employment over an extended period of time. The tendency for capital intensive but low value-added projects, i.e. motorways, expressways, airports and dams, needs to be curbed. The current penchant for constructing more dams for water storage defies economic logic. For example, the Federal Budget 2000-01 allocated 40 per cent of the total development allocation in the water sector to the construction of dams. Dams do not produce water; they merely store it. In the event of a prolonged drought, which is not entirely unlikely given the climate changes underway, reservoirs are likely to remain empty. Water management has emerged as the most crucial issue facing policymakers. However, there is an urgent imperative for a parametric shift of priority from storage to conservation, i.e. from flood irrigation practices to various forms of drip irrigation and from high water intensive to low water intensive crops. Large capital investments would be required to implement this shift, but would accrue significantly higher returns in the future.

The policy of opening up the economy, beyond what is required by World Trade Organization (WTO) standards is also inadvisable. In the past, domestic producers enjoyed unfair advantage relative to imports. A level playing field is perhaps in order. However, a new trade regime is now emerging, where imports are beginning to enjoy an unfair advantage relative to domestic producers. The cost of such a trade regime to the country's industry and economy, and to the people in terms of unemployment and poverty, is likely to be extremely high.

While fiscal policy, in general, and enhancing public investment, in particular, emerge as the most effective tool for regenerating the economy, monetary policy avenues also need to be mobilized. Admittedly, though the causal relationship between monetary policy variables and growth does not seem to be strong, some room for action may arise.

Reduction of the interest rate is one option. Though investment is not known to be sensitive to interest rate changes, it is a fact that with the persistence of low rate of inflation, real interest rates have become rather high, raising the cost of investment. The high cost of capital appears to be inconsistent with the surplus loanable funds available with commercial banks in view of low and falling private sector demand for credit. While no definitive opinion can be expressed, there may be merit in exploring the possibility of a quantum reduction in interest rates–by as much as half–in order to improve the financial contours of the investment climate.

Another more certain possibility would be to introduce a scheme of low interest housing loans. Housing has a large multiplier impact in terms of ancillary economic activity as well as employment. An enhanced level of home ownership would not only be a socially desirable goal, but is also likely to drive the economy out of the recession. A precedent exists in this respect as well. The introduction of lease financing of cars has provided a definite boost to the automobile industry, with its positive linkages with allied sectors.

Housing loans will require some adjustments in the disbursement mechanism in order to enhance their outreach to the poor. In particular, loan size will have to be small, loans will have to be extended for plot purchase in addition to house construction and flexibility will have to be introduced with respect to the size and frequency of repayment instalments.

Attention to institutional factors in housing finance would take care of one aspect of social policy. As indicated at the outset, social policy plays an important role in poverty reduction. This is because the benefits of growth do not necessarily trickle down to all sections of the population. Welfare transfers thus emerge as the instrument with which to reach out to the marginalized sections of the population.

Welfare transfers are, broadly, of two types: direct income support transfers and human capital enhancing transfers. The former include safety nets such as unemployment benefits, food stamps, *zakat*, bait-ul-maal (national welfare authority), public works programmes, microfinance, etc. The latter includes public provision of basic services, such as housing, education, health care, etc.

An appraisal of social safety nets in Pakistan leads to the conclusion that higher priority must be accorded to direct interventions for poverty alleviation. While funding needs to be substantially enhanced, serious attention should also be given to strengthening of institutional structures, efficient targeting and broad-based coverage of current social safety nets programmes. It should be realized, however, that safety nets can only mitigate poverty at the margin and cannot be a substitute for growth-induced employment and income generation. However, even as an instrument of welfare transfers, social security is preferable to social safety nets.

With respect to enhancing support through human capital endowments, there is no substitute to the public provisioning of quality education, health care and clean water and sanitation to all citizens. Equal access to these basic services is a right and it is incumbent on the state to ensure this right. The argument that resources are not available is not tenable. These sectors have traditionally borne the brunt of fiscal economy measures and it is time that economy cuts are applied instead to the hitherto protected current expenditure heads.

Source: Social Policy and Development Centre, Annual Review 2001: Growth, Inequality and Poverty (Karachi: Oxford University Press, 2002), 139–143.

NOTES

1. Shahid Javed Burki was one of the first to alert us to this fact. See Burki, Shahid Javed, 'Poverty Returns to Pakistan?' address given at a Seminar held by the *Pakistan Institute of Development Economics*, mimeo (Islamabad, 4 December 1995). See also the recent monograph by S. M. Naseem on a history of poverty studies in Pakistan: Naseem, S. M., *A Review of Studies on Poverty in Pakistan: Origin, Evolution, Thematic content and Future Directions*, History of PIDE Series-6 (Islamabad: PIDE, 2012).
2. See, for example, Gazdar, Haris, Review of Pakistan Poverty Data (London: DFID, 6 April 1998); Gazdar, Haris, 'Poverty in Pakistan: A Review', in Khan, Shahrukh Rafi, *Fifty Years of Pakistan's Economy* (Karachi: Oxford University Press, 1999); Mahbub ul Haq Centre for Human Development (MHCHD), in collaboration with the United Nations Development Programme, Pakistan (UNDP), *A Profile of Poverty in Pakistan* (Islamabad: MHCHD/UNDP, February 1999). Zaidi, S. Akbar, *An Annotated Bibliography on Poverty in Pakistan*, mimeo (Islamabad: UNDP, 1999), for a complete list and a bibliography of all research on poverty in Pakistan since the 1970s till 1999, also available on http://un.org.pk/library/poverty/pov_biblio.htm and *http://www.cosspak.org/data/bibliography_on_Poverty_Bibliography_by_S._Akbar_Zaidi.pdf;* Social Policy Development Centre (SPDC), *Annual Review 2000: Towards Poverty Reduction* (Karachi: Oxford University Press, 2001); Social Policy Development Centre, *Annual Review 2001: Growth, Inequality and Poverty* (Karachi: Oxford University Press, 2002); World Bank, *Pakistan Poverty Assessment*, Report No. 24296-PAK (World Bank, October 2002); Hussain, Akmal, *Pakistan: National Human Development Report 2003* (Islamabad: UNDP, 2003); and Centre for Research on Poverty Reduction and Income Distribution (CRPRID), *Pakistan Human Condition Report 2003* (Islamabad, November 2003). The recent monograph by S. M. Naseem cited in Note 1 also has a great deal of information and analysis of these and related issues.
3. See the study by Gazdar, 1998, and Gazdar, 1999, for details on methodology and estimation; Zaidi, 1999, also presents comments and summaries of all papers published on poverty in Pakistan, and some comments on methodology; SPDC, 2001, SPDC 2002, World Bank, 2002, and CRPRID,

2003 also have discussion on how poverty is estimated and on poverty lines. The recent monograph by S. M. Naseem (2012) is essential reading since it covers these issues effectively.

4. Of the nearly fourscore papers and reports on poverty in Pakistan, only a few have explained trends in poverty; a vast majority have simply estimated poverty lines and the percentage of the population below these lines. See, Zaidi, 1999.
5. In this chapter we look at primarily income poverty.
6. See Gazdar, 1998, and Gazdar, 1999, for a note on methodology, and Zaidi, 1999, for the different approaches used to estimate poverty in Pakistan.
7. However, it is necessary to add a word of caution in any such comparisons, as does the MHCHD/UNDP Report, 1999: 'Due to different units of measurement, disparate counting units, divergent cut off points and the selection of arbitrary and different poverty lines, these studies provide conflicting measures of poverty', 7.
8. Gazdar, Haris, Steven Howes, and Salman Zaidi, *Pakistan: Recent Trends in Poverty*, mimeo (London: STICERD,LSE, 1994).
9. World Bank, *Pakistan Poverty Assessment*, Report No. 14397-PAK (Washington DC: World Bank, 1995).
10. See Zaidi, 1999, for the recent literature.
11. The reason for this is that the SPDC, 1998, study uses the World Bank's method of using the headcount approach in assessing the proportion of the population with incomes of less than one dollar per day on a purchasing parity basis. Hence, these estimates differ considerably from other, consumption-based, approaches.
12. The Gini coefficient is a measure which shows the degree of income inequality over time and/or across countries. The closer the Gini is to 1.00, the greater the inequality, and the closer it is to 0.00, the more equitable income distribution
13. See MHCHD/UNDP, 1999, 85.
14. Pakistan Country Management Unit, South Asia Region, *Country Partnership Strategy for the Islamic Republic of Pakistan for the Period FY 2001–13*, Report No. 53553-PK (Islamabad: World Bank, 30 July 2010), 8.
15. World Bank, 1995, iii.
16. Planning Commission, Government of Pakistan, Draft Chapter on Poverty Alleviation for the Ninth Five-Year Plan (1998–2003), Islamabad, 1998b, 4.
17. Irfan, M. and R. Amjad, 'Poverty in Rural Pakistan', in Khan, A. R. and E. Lee, (eds.), *Poverty in Rural Asia* (Geneva: ILO/ARTEP, 1984).
18. For an extensive debate about the nature and extent of the structural changes and relations that took place in the 1960s, see Chapters 1, 3 and 26.
19. See Gazdar, 1998, 8, and Burki, 1995, 3.
20. Gazdar, 1998, 3.
21. Tahir, P., 'Poverty Alleviation Policies: A Historical Perspective', in Mahbubul Haq Centre for Human Development, Islamabad, in collaboration with the United Nations Development Programme, Pakistan, *A Profile of Poverty in Pakistan*, (Islamabad, February 1999),112.
22. For the reasons why economic growth during this period was not of 'historical proportions', see Chapter 6, where it has been shown that rather than simply blaming the Bhutto government for its poor economic policies, it is perhaps more important to critically reassess this period, where numerous 'bad luck' factors—such as the OPEC price rise, floods, pest attacks, etc.—may have had a bigger impact.
23. Tahir, 1999, 109.
24. Ibid., 111. See Tahir, 1999, for greater details of the Bhutto government's social and economic policies.
25. Ibid. 110.
26. See Amjad, R., and A. R. Kemal, 'Macroeconomic Policies and their Impact on Poverty Alleviation in Pakistan', *The Pakistan Development Review*, vol. 36, no 1, Spring 1997, 39–68.
27. See in particular, Addleton, J., *Undermining the Centre: Gulf Migration and Pakistan* (Karachi: Oxford University Press, 1992).
28. See especially, MHCHD/UNDP, 1999; Gazdar, 1998; Amjad and Kemal, 1997; World Bank, 1995; and Burki, 1995.
29. Tahir, 1999, 118.
30. Ibid. 118.
31. Ibid. 118.
32. See also Chapter 17 of this book for greater details.
33. For more extensive details on the Structural Adjustment Programme, see the references cited in Chapters 16 and 17 of this book.
34. Cited in Tahir, 1999, 126.
35. Planning Commission, Government of Pakistan, 1998b, 3.
36. Amjad and Kemal, 1997, 56.
37. Sayeed, A., and A. F. A. Ghaus, 'Has Poverty Returned to Pakistan?', *Social Policy and Development Centre*, mimeo (Karachi: SPDC, 1996).
38. See Kemal, A. R., 'Structural Adjustment, Employment, Income Distribution and Poverty', *Pakistan Development Review*, vol. 33, no 4, 1994.
39. Khan, 1997, 203–4.
40. See Kemal, 1994.
41. See Ibid.
42. See Sayeed and Ghaus, 1996.
43. See Tahir, 1999, 125.
44. See Kemal, 1994.
45. Planning Commission, Government of Pakistan, 1998, 6.
46. Planning Commission, Government of Pakistan, 1999, 14.
47. The other factors which affected Pakistan's economy between 1988 and 2004, included lower remittances, political instability as reflected by frequent changes of government although, the economic restructuring policies remained more or less unchanged since 1988, and the sharply deteriorating law and order situation, as well as economic sanctions.
48. This is also evident from a bibliographical review, where earlier attempts were made at measuring poverty and only recently has there been any analysis on its causes and cures; see Zaidi, 1999.
49. This part of the chapter is based on the work by Addleton, 1992.
50. Ibid. 4.
51. Ibid. 88.
52. Ibid. 95–6.
53. Ibid. 137.
54. Ibid. 125.
55. Ibid. 147–8.
56. Ibid. 153.
57. Ibid. 155.
58. Quoted in Addleton, 1992, 163, fn.
59. See for example, Planning Commission, Government of Pakistan, 1999; Planning Commission, Government of

Pakistan, 1998; and The Task Force on Poverty Alleviation, Government of Pakistan, 1997.
60. See Planning Commission, Government of Pakistan, 1999; Planning Commission, Government of Pakistan, 1998; and, The Task Force on Poverty Alleviation, Government of Pakistan, 1997.
61. Planning Commission, Government of Pakistan, 1999, 6.
62. Ibid. 8.
63. Ibid. 8.
64. Tahir, 1999, 126.
65. Gazdar, 1998, 13.
66. Burki, 1995, 10.
67. Beall et al., 1994, ix.
68. Ibid. 4.
69. Burki, 1995, 2.
70. Ibid. xii.
71. See Zaidi, 1999; and SPDC, 1998.
72. I am grateful to Asad Sayeed for making this point.
73. J. Beall et al. Social Safety Nets and Social Networks: Their Role in Poverty Alleviation in Pakistan, Volume 1: Executive Summary and Report, (London: DPU, University College London, 1994).
74. Planning Commission, Government of Pakistan, 1998, 15.
75. See Chapters 5 and 6.
76. Gazdar, 1998, viii.
77. There have been some studies in the last few years which attempt an examination of the issue of bonded labour in Pakistan. These include: Pakistan Institute of Labour Education and Research (PILER), *Bonded Labour in Pakistan: An Overview* (Karachi: PILER, October 2000); Consultant's Report, *Bonded Labour Report Vols. 1 and 2*, (This Report was undertaken for the Planning and Development Department, Government of Sindh, and the Asian Development Bank), April 2000; Agrodev Canada Inc., *Sindh Rural Development Project: Social Assessment Report, March 2000*; ActionAid Pakistan, *Bonded Labour in Sindh* (Islamabad: ActionAid, March 1999); and, Anti-Slavery International, *The Menace of Bonded Labour: Debt Bondage in Pakistan* (London: Anti-Slavery International, 1996). Each of the studies cited above also contains references to articles in the local press on bonded labour. It is probable that there are other reports and studies which also examine the theme of bonded labour in Pakistan, but we are not aware of them.
78. Anti-Slavery International, op. cit., 15.
79. In mentioning non-debt related forms of being bonded, one must also add that given Pakistan's social, cultural and religious norms and practices, most women in Pakistan are also subject to extreme forms of being 'bonded' and are unfree in every sense of the word.
80. Ibid. 14.
81. Gazette of Pakistan, Extraordinary, *Bonded Labour System (Abolition) Act, 1992*, 17 March 1992.
82. It is important to come to an acceptable working definition of bonded labour, as we found during the course of this study, some individuals questioned the category 'bonded' labour as no such definition existed.
83. Agrodev Canada Inc., *Sindh Rural Development Project: Social Assessment Report*, March 2000, 30.
84. ActionAid, op. cit., 6.
85. PILER, op. cit., 5.
86. Ibid. 14.
87. Ibid. 23.
88. Ibid. 9.
89. Ibid. 8.
90. Anti-Slavery International, op. cit., 14.
91. Throughout this chapter we have used the concept of income poverty rather than human or basic needs poverty. This is done as a matter of convenience, since income poverty comparisons run further backwards into time than any other estimates. Moreover, it has also been shown that, the pace of human development 'precisely mirrors the pace of economic growth and the pattern of income poverty incidence', (Islamabad: MHCHD/UNDP, 1999), 53. Also, in times of extended economic crises and recessions, perhaps income and the lack of it, better reflect the situation of the poor, as has recently been observed in East Asia.

23 Regional and Income Inequalities

23.1 Regional Inequalities: Districts and Provinces[1]

For a country that has lost more than half its people, who have chosen to become independent on the grounds that they were discriminated against, we would suggest that economic, social, and political imbalances between regions are serious issues. The economic policies that favoured West Pakistan at the expense of East Pakistan resulted in the western wing of pre-1971 Pakistan developing at a much faster pace than the eastern half of the country. Economists and politicians in the 1960s argued that much of the development in West Pakistan was due to the extraction of surplus from East Pakistan, a surplus that benefited and was reinvested in the western half of Pakistan. East Pakistanis were discriminated against socially, economically, and politically, and hence were forced to express their rights of collective identity, leading towards greater autonomy and subsequently, to independence.

Since the larger part of pre-1971 Pakistan broke away and became Bangladesh, there have been numerous political movements based on the perception that their unit (province), language, people, or nationality has been discriminated against. The consequence of this perception has been protest against the federal structure and federal government in various ways. In the early 1970s, some Baloch leaders fought a 'war of independence' against Islamabad under Bhutto as they did again under Musharraf and after 2008. In the early 1980s, political parties from Sindh agitated against the dictatorship of General Zia ul-Haq under the banner of the Movement for the Restoration of Democracy (MRD), a movement which eventually acquired a Sindhi nationalist colour. For much of the 1970s, the people of the NWFP, the Pakhtuns, were considered to be outside mainstream politics, with supposed designs of a Greater Pakhtunistan which included much of Afghanistan. The late 1980s and early 1990s saw the emergence of possibly the worst and most brutal forms of protest and subsequent repression since the independence of East Pakistan: in Karachi, after the Muhajir Qaumi Movement (MQM) emerged demanding rights for the Urdu-speaking people of Sindh, mainly Karachi and Hyderabad.[2] Other than the Punjab, all major linguistic and ethnic groups have, at some time or other, protested against and confronted the federal structure. In the Punjab itself, the Seraiki belt in the south has felt discriminated against through settlers and by inhabitants of central Punjab. Such developments after the restoration of democracy in 2008, led to demands for greater provincial autonomy, fiscal federalism and greater responsibility to be transferred to the existing provincial units in Pakistan. These considerations and demands resulted in the Seventh National Finance Commission Award and the Eighteenth Amendment to the Constitution of Pakistan, and although the consequences of such interventions are still not clear, they have altered the existing balance between the federation and the provinces—see Chapter 12 on Fiscal Federalism. Many of these measures were undertaken to address issues of real and perceived regional inequality and deprivation.

With such a history of protest, which usually involves the loss of hundreds, possibly thousands, of lives, one cannot ignore the importance of regional, linguistic, and ethnic issues in Pakistan. We need to assess whether the fears of discrimination are indeed real or mere perception, or worse still, are issues created purely to gain political advantage. Political scientists and historians have their own way of looking at the evolution of specific societies, languages, and ethnic groups, while economists can perhaps identify economic factors that differentiate amongst regions. Economic factors are usually, if not always, the main cause of protest, and instigate the perception that a particular region, province, or people are consciously being discriminated against. However, even if such claims are justified, there are very serious methodological issues in determining biases and imbalances.

The first issue concerns the size, composition, and extent (area) of the region or people who feel that there is economic and social imbalance against them. Does one choose a province, city, or collection of similar types of people? For example, if we were to argue that Sindh was being discriminated against, how would we determine who in Sindh was being discriminated against and to what extent? Is it all the people living in the province? Only those who speak Sindhi, i.e. the Sindhis? The rural Sindhis? The non-Sindhi rural settlers? The city dwellers? Some sections of the city dwellers, e.g. the Urdu-speaking Mohajirs, or the migrant Seraikis? And if it is at all possible to isolate the area/region/group which claims that it is being discriminated against, how does one measure discrimination? Is it share of employment in government jobs with respect to share of population in the country? Is it lack of private sector investment in a certain area? Does greater contribution to the government's exchequer in the form of taxes, with lower return in the form of government expenditure, qualify as discrimination? How important is cultural indifference? Furthermore, even if we are able to isolate and distinguish a region or an ethnic group in order to examine the extent of perceived or real discrimination,

another important question arises: which social group in that ethnic group is discriminated against? How important are class and social differentiation? Is it the élite or the middle class demanding its 'national' rights, or the workers or peasants who want deliverance from discrimination and 'oppression' by a dominant national group? And what about exploitation by members of one's own community? Is that any better or different from 'national' exploitation? Clearly, the questions are endless.

Moreover, while some of the issues of identification highlighted above are difficult, even if we do isolate a region for the purposes of analysis, we are faced with a set of other problems. What do we select in identifying imbalances? Do we look at industrialization, income, schooling, the extent to which women are part of the labour force, or some or all of these indicators? There is an even more fundamental question: what constitutes development? Is development more income, or is it a non-material quality of life, as some observers feel? The attempt to compare countries in Chapter 19 shows how difficult, and often contradictory, comparisons can be. Besides, looking at a set of indicators at any one point in time is quite meaningless, unless one considers trends over a period of time and examines these unfolding trends and the directions they are taking. The *process* is the key to deciphering and understanding what development, absolute or relative, really is.

However, having set these rather high ideals for regional comparisons, in this chapter we will limit ourselves to some preliminary quantitative analysis which does not take sufficient cognizance of historical processes and phenomena.[3] We now present some of the more basic and conventional methods that attempt to compare districts, followed by some results that this methodology generates.

23.1.1 Methodology and Results

Table 23.1 has become a fairly standard table showing the 46 districts of Pakistan which existed at that time, ranked by five different and independent studies, using different criteria. The fact that when the first study was undertaken in the 1960s there were 46 districts, while now there are more than 110, means that all attempts to interpret the table must be made with considerable caution. Add to this the problem that each of the studies uses different sets of indicators and different methodologies in composing its indices and rankings, and even more caution is required to interpret the table.

Nevertheless, many 'results' shown in the table are probably intuitive in the first instance, and despite problems with methodology and choice of indicators, it is probable that Karachi would still top anyone's list as the 'most developed district', with the four provincial headquarters following behind. Moreover, large and dynamic cities like Faisalabad, Gujranwala, and Hyderabad would also have a high ranking. Not surprisingly, one would expect most of the districts of Balochistan to have a lower development ranking.

The third column of Table 23.1 is based on an evaluation by Hafiz Pasha and Tariq Hasan for the 1970s, while the fifth column uses similar indicators employed by Hafiz Pasha and his colleagues in the 1980s. Hence, some inter-temporal comparisons are possible. Those districts that the authors feel have shown dynamism in the 1980s compared to the 1970s were Dadu, Larkana, and Jacobabad, as well as Sanghar, Nawabshah, and Khairpur. The north-western districts of the Punjab, especially Rawalpindi, Attock, Jhelum and Gujrat, improved their rank, as did Peshawar, Mardan, Hazara and Kohat. The main feature of the two columns is the decline of the south of Punjab, where districts such as Multan, Muzaffargarh, Dera Ghazi Khan, Bahawalnagar and Rahim Yar Khan have all seen a fall over time. Balochistan's backwardness continues unabated, a fact also supported by poverty figures—see Chapter 22.

At a provincial level, the two studies by Hafiz Pasha and his colleagues show how the share of the populations have shifted over time. Table 23.2 indicates that in the 1980s, of the total percentage of the population in the top quartile by development level, 53.2 per cent was in the Punjab, 34.6 per cent in Sindh, 10.5 per cent in the NWFP, and only 1.8 per cent in Balochistan. The comparison with the 1970s showed that the Punjab's share increased significantly. The authors believed that 'while some of this change can be attributed to changes in district boundaries, it testified to the buoyancy in some of the larger cities of the Punjab and an enhancement, in particular, in the share of industrial value added'.[4] The reason for the dominance of the Punjab in the second quartile was the 'dynamism of the small-scale industrial sector in the province and the establishment of stronger urban–rural linkages'.[5] The significant jump of the NWFP in this category was due to the presence of Abbotabad, Mardan, and Kohat. In the bottom quartile there were 29 districts (of the 62 surveyed), 14 of which were in Balochistan and 5 each in the three other provinces. However, the share of the Punjab in the lowest population quartile was close to 41 per cent, Sindh 23 per cent, NWFP 18 per cent and Balochistan 18 per cent. The results of these two studies indicated that 'even the relatively developed provinces like Sindh and Punjab have large underdeveloped pockets. Comparison with the shares in the early 1970s reveals that the share of Balochistan [in the bottom quartile] has increased, while that of the other provinces has declined somewhat. This points to the possibility that the gap between Balochistan and the rest of the country has widened even further.'[6]

Table 23.2 shows that in the 1970s, of all the population in Pakistan in the top quartile by level of development, 41.8 per cent was in the Punjab; similarly, while the next quartile was distributed between the NWFP and Punjab, almost all were in the latter province; likewise, Punjab contained 45.4 per cent of Pakistan's poor. Table 23.3 looks at the same data in a different manner. Here we see an even clearer result: as much as 91 per cent of Balochistan's population was in the bottom quartile, while only 18 per cent of Punjab's population was in the bottom quartile. Similarly, while 41.8 per cent of the entire country's population in the top quartile was in the Punjab, this constituted only 18 per cent of the Punjab's population. What is more interesting is that, while the NWFP and the rest of Sindh (i.e. the province of Sindh minus Karachi) have 27 and 21 per cent of their population in the relatively better districts, unlike the Punjab, both have only

Table 23.1
Comparative Ranking of Districts in Pakistan—Panel A

	Infrastructure of social development (Heblock and Naqvi, 1960)	Infrastructure and production indices (Hamid and Hussain, 1970)	Infrastructure and social development (Pasha and Hasan, 1970s)	Infrastructure (Qutub, 1980s)	Infrastructure and social development (Pasha et al. 1980s)
Punjab					
Lahore	2	2	2	4	2
Rawalpindi	4	3	3	2	3
Faisalabad	7	4	7	10	7
Multan	8	5	9	11	13
Jhelum	9	7	16	9	15
Rahimyar Khan	12	10	15	27	19
Gujrat	13	8	23	19	16
Gujranwala	14	9	8	15	8
Sargodha	16	16	20	14	23
Sahiwal	17	6	14	21	25
Bahawalnagar	18	17	28	30	30
Sheikhupura	21	12	12	6	21
Mianwali	23	20	34	25	33
Dera Ghazi Khan	25	21	35	35	36
Sialkot	26	11	10	12	12
Muzaffargarh	31	25	31	31	37
Jhang	33	26	24	23	28
Attock	27	22	33	13	32
Sindh					
Karachi	1	1	1	1	1
Hyderabad	6	15	6	7	4
Sanghar	10	15	18	32	10
Sukkur	19	18	21	8	9
Nawabshah	22	24	22	29	18
Jacobabad	24	37	37	38	35
Khairpur	28	23	26	33	22
Dadu	30	31	25	24	24
Larkana	32	27	27	20	17
Tharparkar	34	37	19	40	27
Thatta	37	32	30	39	31
NWFP					
Peshawar	3	13	5	5	5
Bannu	11	36	29	18	29
Mardan	15	14	13	26	11
Kohat	29	35	32	22	26
Dera Ismail Khan	35	33	11	16	20
Hazara	36	34	36	17	34
Balochistan					
Quetta	5	30	4	3	6
Chagai	38	38	40	34	38
Kharan	39	46	44	45	45
Sibbi	40	42	41	37	40
Zhob	41	41	38	36	41
Kalat	42	44	43	42	43
Loralai	43	43	39	41	42
Mekran	44	45	42	44	46
Katchi	45	39	46	43	44
Lasbela	46	40	45	46	39

Sources: Kardar, Shahid, 'Polarization in the Regions and Prospects for Integration', in Zaidi, S. Akbar, *Regional Imbalances and the National Question in Pakistan* (Lahore: Vanguard, 1992), 322–3; Pasha, Hafiz A et al. 'The Changing Profile of Regional Development in Pakistan', *Pakistan Journal of Applied Economics*, vol. 9, no. 1, 1990, 21.

Table 23.1: (Continued)
Comparative Ranking of Districts in Pakistan 2002—Panel B

District	Province	Rank
TOP QUARTILE (Developed Districts)		
Karachi	Sindh	1
Lahore	Punjab	2
Peshawar	NWFP	3
Quetta	Balochistan	4
Rawalpindi	Punjab	5
Sialkot	Punjab	6
Jhelum	Punjab	7
Gujrat	Punjab	8
Gujranwala	Punjab	9
SECOND QUARTILE		
Faisalabad	Punjab	10
Ziarat	Balochistan	11
Multan	Punjab	12
Hyderabad	Sindh	13
Chakwal	Punjab	14
Attock	Punjab	15
Sahiwal	Punjab	16
T. Tek Singh	Punjab	17
Abbottabad	NWFP	18
Sheikhupura	Punjab	19
Sargodha	Punjab	20
Upper Dir	NWFP	21
Kohat	NWFP	22
M. Bahauddin	Punjab	23
Sukkur	Sindh	24
Bahawalpur	Punjab	25
Sibi	Balochistan	26
Narowal	Punjab	27
Hafizabad	Punjab	28
Haripur	NWFP	28
THIRD QUARTILE		
Kasur	Punjab	30
Vehari	Punjab	31
Khanewal	Punjab	32
Mianwali	Punjab	33
Jhang	Punjab	34
Okara	Punjab	35
Larkana	Sindh	36
Nawabshah	Sindh	37
Khushab	Punjab	38
Mardan	NWFP	39
Rahim Yar Khan	Punjab	40
Pishin	Balochistan	41
Gwader	Balochistan	42
Bahawalnagar	Punjab	43
Mirpurkhas	Sindh	44
Mastung	Balochistan	45
Panjgur	Balochistan	46
Loralai	Balochistan	47
Chaghai	Balochistan	48
Mansehra	NWFP	49
Jafarabad	Balochistan	50
Killa Saifullah	Balochistan	51
Pak Patten	Punjab	52
Kech (Turbat	Balochistan	53
Sanghar	Sindh	54
Muskhal	Balochistan	55
Kohlu	Balochistan	56
Bannu	NWFP	57
Chitral	NWFP	58
BOTTOM QUARTILE (Backward Districts)		
Layyah	Punjab	59
Ghotki	Sindh	60
Bhakkar	Punjab	61
N. Feroze	Sindh	62
D. G. Khan	Punjab	63
Nowshera	NWFP	64
Khairpur	Sindh	65
Dadu	Sindh	66
Kalat	Balochistan	67
Lasbela	Balochistan	68
Lodhran	Punjab	69
D. I. Khan	NWFP	70
Muzaffar Garh	Punjab	71
Charsadda	NWFP	72
Malakand	NWFP	73
Zhob	Balochistan	74
Shikarpur	Sindh	75
Kharan	Balochistan	76
Swat	NWFP	77
Karak	NWFP	78
Bolan	Balochistan	78
Barkan	Balochistan	79
Jacobabad	Sindh	81
Khuzdar	Balochistan	82
Swabi	NWFP	83
Rajanpur	Punjab	84
Dera Bugti	Balochistan	85
Jhal Magsi	Balochistan	86
Umerkot	Sindh	87
Tank	NWFP	88
Badin	Sindh	89
Lakki	NWFP	90
Thatta	Sindh	91
Tharparkar	Sindh	92
Killa Abdullah	Balochistan	93
Nasirabad	Balochistan	94
Buner	NWFP	95
Hangu	NWFP	96
Kohistan	NWFP	97
Awaran	Balochistan	98
Shangla	NWFP	99
Lower Dir	NWFP	100
Battagram	NWFP	101

Source: Wasti, Syed Ashraf and Minhaj Uddin Siddiqui, 'Development Rank Ordering of Districts of Pakistan, Revised,' unpublished paper, 2002.

Table 23.2
Changing Profile of Development by Province: Share of Provinces in Population Quartiles by Level of Development (%)

	Punjab	Sindh	NWFP	Balochistan
1990s				
Top Quartile	59.8	31.3	6.4	2.4
Second Quartile	81.2	11.8	6.3	0.7
Third Quartile	61.8	16.5	13.3	8.4
Bottom Quartile	27.0	35.1	29.0	8.9
Total	57.4	23.7	13.8	5.1
Early 1980s				
Top Quartile	53.2	34.6	10.5	1.8
Second Quartile	76.6	5.5	17.2	0.7
Third Quartile	62.1	29.7	8.3	0.0
Bottom Quartile	40.8	22.6	18.1	18.4
Total	56.1	22.6	13.1	5.1
Early 1970s				
Top Quartile	41.8	42.1	12.4	3.6
Second Quartile	96.8	0.0	3.2	0.0
Third Quartile	64.9	27.6	7.5	0.0
Bottom Quartile	45.4	23.5	19.4	11.7
Total	57.9	21.2	12.8	3.7

Source: For the early 1970s and 1980s, Pasha, Hafiz et al. 'The Changing Profile of Regional Development in Pakistan, *Pakistan Journal of Applied Economics*, vol. 9, no. 1, 1990, 15; for the 1990s, Wasti, Syed Ashraf and Minhaj Uddin Siddiqui, 'Development Rank Ordering of Districts of Pakistan: Revised', unpublished paper, 2002.

one district each in this category. Peshawar for the NWFP, and Hyderabad for the Rest of Sindh, constituted a large share of the population of their regions, both in the top quartile, while Punjab's 18 per cent, though less in terms of population, had two districts in the top quartile. This shows that, at least in the 1970s (and possibly even today), the Punjab had a more even spread of population and development than the other provinces.[7]

As we have argued earlier, social infrastructure, especially the levels of literacy and education attained by a population, have important consequences for levels of development. Hence it would be useful to examine the level of regional disparities in social infrastructure. Table 23.4, shows a huge variation in literacy rates across the provinces in Pakistan. Punjab's overall literacy rate used to be three times that of Balochistan, which was close to one-seventh that of Karachi. The female literacy rate, a key ingredient in health care and family planning, was particularly poor in rural areas, with the Punjab showing the highest, albeit dismal, literacy rates for rural women. Table 23.5 introduced some more recent statistics, seeming to indicate that rural NWFP performed very well compared to the other rural areas in the provinces. The maldistribution within rural Punjab, where the growth of literacy among Seraiki-speakers is far worse than in the more prosperous central and northern belts, is reflected in a lower average for the Punjab. Punjab's urban figures are particularly impressive, implying that the high level of urbanization may have brought positive consequences for health and education. Surprisingly, despite Karachi's dominance of urban Sindh, urban Punjab performs better than urban Sindh. It is also important to emphasize, as we show below, that even within provinces, such as the Punjab, there are wide differences in indicators which indicate disparate development—see Box 23.1 and Box 23.2.

Using an index which makes use of a number of indicators, Haroon Jamal and his colleagues have devised a district-level Index of Multiple Deprivation—see Table 23.6—and have listed districts by their rank of development (or, deprivation) over a period of seven years, between 1998 and 2005.[8] Panel A in table 23.6 shows that while Karachi and Lahore were the 'least deprived districts' of Pakistan in 1998, their position remained the same in 2005. In these seven years, Gujranwala improved its relative position, becoming the third 'least deprived' district of Pakistan, and with the exception of Rawalpindi and Sialkot, all the other districts in the top ten category, improved their position between 1998 and 2007. Panel B shows, again, not surprisingly, that the top ten 'most deprived' districts, or the least developed districts, are all in Balochistan.

Abid Burki and his colleagues at LUMS, have looked at issues of regional poverty in Pakistan over the period 1990–2006.[9] Table 23.7 shows data which confirms many of the arguments suggested earlier, such as the fall in overall poverty, the sharp fall in urban poverty, the persistence of higher rural poverty, and the relative position of the provinces

Table 23.3
Percentage of Population within Provinces and Development Levels

	Top quartile	Second quartile	Third quartile	Bottom quartile	Total
Punjab	18	37	27	18	100
Karachi	100	0	0	0	100
Rest of Sindh	21	0	43	36	100
NWFP	27	7	18	48	100
Balochistan	9	0	0	91	100

Source: Zaidi, S. Akbar, 'The Economic Bases in the National Question in Pakistan: An Indication', in Zaidi, S. Akbar, *Regional Imbalances and the National Question in Pakistan* (Lahore: Vanguard, 1991), 126.

Table 23.4
Literacy Rates in Pakistan: 1972, 1981, 1998 (%)

	Total			Urban			Rural		
Unit	Both sexes	Male	Female	Both sexes	Male	Female	Both sexes	Male	Female
Pakistan									
1998	43.9	54.8	32.0	63.1	70.0	55.2	33.6	46.4	20.1
1981	26.2	35.0	15.9	47.1	55.3	37.2	17.3	26.2	7.3
1972	21.7	30.2	11.6	41.5	49.9	30.9	14.3	22.6	4.9
NWFP									
1998	35.4	51.4	18.8	54.3	67.5	39.1	31.3	47.6	14.7
1981	14.3	22.7	4.9	32.1	42.8	18.8	10.9	18.7	2.5
1972	14.5	23.1	4.7	33.7	44.7	19.9	11.0	19.0	2.2
Punjab									
1998	46.6	57.2	35.1	64.5	70.9	57.2	37.9	50.4	24.8
1981	24.5	33.5	14.4	43.1	51.5	33.2	17.3	26.4	7.4
1972	20.7	29.1	10.7	38.9	47.8	28.0	14.7	22.9	5.2
Rest of Sindh									
1998	33.4	45.00	20.4						
1981	21.0	30.0	10.0	–	–	–	12.7	20.8	3.4
1972	22.5	32.6	10.0	–	–	–	17.6	27.5	5.8
Balochistan									
1998	24.8	34.0	14.1	46.9	58.1	33.1	17.5	25.7	7.9
1981	8.2	12.5	2.9	27.9	37.7	14.3	4.4	7.3	0.8
1972	10.1	14.8	4.2	32.3	42.4	19.2	5.6	9.2	1.2
Karachi									
1998	67.49	71.1	62.9						
1981	55.0	60.0	48.8	–	–	–	–	–	–
1972	51.2	55.8	45.0	–	–	–	–	–	–

Source: Population Censu Organization, *Population Census Reports* (Islamabad: various issues).

Table 23.5
Regional Differences in Human Development Indicators: 1991

	Literacy rates		Net primary school enrolment rates		Infant mortality rate (per thousand)
	Male (%)	Female (%)	Male (%)	Female (%)	
Punjab					
Urban	62.9	36.8	81.1	78.5	89
Rural North	44.6	13.6	70.8	52.9	111
Rural South	34.5	8.9	61.0	32.2	147
Sindh					
Urban	61.5	41.3	63.3	63.3	92
Rural	43.2	6.6	51.5	24.1	143
NWFP					
Uban	53.8	20.9	81.3	53.5	154
Rural	43.9	5.4	72.2	36.9	128
Balochistan					
Urban	52.0	16.5	44.9	34.0	201
Rural	29.1	3.2	47.3	19.8	149
All Pakistan					119

Notes: Literacy rates are for population 15 years of age and older. Net primary school enrolment refers to grades 1–5, ages 6–10. Infant mortality rates are deaths in the 0–1 age bracket per thousand live births (average for the 1980–90 period).

Source: Behrman, J. R., 'Pakistan: Human Resource Development and Economic Growth into the Next Century', unpublished mimeo, 8 May 1995.

Box 23.1

Poverty Across the Punjab

Ali Cheema examines the variability of poverty across the Punjab showing its wide variation.

. . . I divide Punjab into four regions. The north consists of the four districts of Rawalpindi, Attock, Jhelum and Chakwal. The west consists of the districts of Mianwali, Bhakkar, Khushab, Layyah, Muzaffargarh, D. G. Khan and Rajanpur. The south consists of the districts of the old Multan division and the old Bahawalpur state. The centre contains the remaining districts of the province.

Using a poverty line based on the Economic Survey methodology, we find that north Punjab has poverty head-count ratios (HCRs) of around 12 per cent and the centre has HCRs in the range of 20 per cent. In contrast, the west and the south of Punjab have HCRs of around 45 per cent, indicating the existence of poverty levels that are more than double those found in the north-centre districts of the province.

Interestingly, rural poverty calculations show a similar trend. In the north, rural poverty remains extremely low and more or less in line with overall poverty in the region. However, in the case of the centre, rural HCRs are 10 per cent higher than overall HCRs in the region at nearly 30 per cent compared to 20 per cent. In the south and the west rural HCRs are extremely high and in the range of 55 per cent.

The severity of poverty in the south-west, measured by the shortfall in household expenditure from the poverty line, is six times higher than the north and three times higher than the centre. This indicates that more than half the rural population of the south-west districts in one of Pakistan's most developed provinces is living in conditions of endemic and abject poverty.

Nearly a decade ago, Haris Gazdar using a different dataset that was unrepresentative at the district level, found similar gaps in sub-provincial poverty in Punjab, with the south and west emerging as the endemic poverty belt of the province. In spite of the statistical issues with the dataset, it appears that he had found an essential insight into the structure of poverty in Pakistan, which has failed to find appreciation in policymaking.

Writing at the time of independence, Malcom Darling documented exactly the same sub-provincial gaps in poverty across Punjab. This suggests that the current regional gaps in poverty across Punjab appear to have persisted over the long run.

Furthermore, our analysis suggests that seven districts in Punjab have rural poverty HCRs of over 60 per cent. These include the districts of: Muzaffargarh; D. G. Khan; Rajanpur; Rahimyar Khan; Bahawalpur; Bahawalnagar and Lodhran. Together these seven districts constitute a crescent of endemic poverty at the bottom of the province. We also find that the severity of poverty tends to be the highest in this crescent.

Punjab's endemic poverty crescent is in stark contrast to the districts of Sialkot, Jhelum, Rawalpindi, Chakwal, Gujrat, Lahore, and Attock, which have poverty HCRs of below 15 per cent and a low severity of poverty ratio. The extremes of poverty in Punjab in 2003–04 ranged from a poverty HCR of six per cent in Sialkot to HCRs of more than 65 per cent in Rajanpur.

These findings have important implications and raise important questions. The most important implication is that there are many Pakistans existing in the state of Pakistan. The people of these different Pakistans have different opportunities, aspirations, and access to different assets and endowments and are faced with different constraints. In some parts a majority of citizens are concerned with improving livelihoods, in others they are battling to survive the disease of abject poverty.

These differences in outcomes will clearly have important implications for the design of a programme of social justice in Pakistan. The findings suggest that the one-policy-fits-all approach adopted by the provincial and federal governments is unlikely to work. This will, in all likelihood, increase the poverty gap between different sub-provincial regions and different types of households.

It also suggests that on an index of abject poverty the placement of citizens from all districts is not equal and a policy emphasis on reducing averages may benefit residents of some regions more than others, as has been the case during the previous regime. Growing gaps at the sub-provincial levels are going to weaken the country politically.

The most obvious question that needs to be addressed is why poverty tends to be endemic and persistent in the high-poverty districts and sub-provincial regions as opposed to the low-poverty districts. And, finally, what implications does this have for policy.

Source: Cheema, Ali, 'Stress on Poverty Reduction', *Dawn*, Karachi, 7 April 2008.

regarding poverty—see also Figures 23.1 and 23.2. One of the more significant findings from their study was, that 'it thus appears that lower distinct-level road density substantially increases rural poverty. It is clear from these results that investments in road infrastructure are most pro-poor'.[10] See also Boxes 23.2, 23.3 and 23.4.

23.1.2 The Issues

Much of the research that has been undertaken on regional or inter-district disparities lacks an analysis of the *reasons* for the differences between areas and regions. Some researchers have not been interested in looking at the issues behind the numbers, while others have tried to shy away from what are heated and controversial political issues. In this section, we present some of the explanations that have been offered for why imbalances exist in the first place, why they either continue to exist or are exacerbated, and how the differences over time can be decreased.

Box 23.2

Regional Inequality Trends in Pakistan

For this study we use household data (rather than grouped data) from seven rounds of HIES from 1990–91 to 2005–06 to calculate Gini expenditure inequality measure described above. The time profile of Gini inequality measure across rural and urban areas can be envisioned in Table 4.6 and Figure 4.7 where the progress made through the periods shows two types of patterns. One type displays that in the beginning of the period national inequality followed a fairly continuous and smooth upward trend showing worsening income distribution. This trend was generally corroborated by other studies [Anwar (2005), Jamal (2009)]. And the other pattern displays a reversal of this trend after 1998–99 when Gini coefficient sharply decreased from 34.27 in 1998–99 to 30.41 and 30.55 in 2000–01 and 2005–06, respectively.

The quintile shares in Table 4.6 are remarkable which indicate marginal decline in the share of poorest 20 per cent from 1990–91 to 1996–97 with a considerable decline in 1998–99 but still with a larger share at the end as it was at the beginning of the period. The middle 40 per cent of the population eroded its income share from 1990–91 to 1998–99 before its recovery at the end of the period. The major beneficiaries, however, were the richest 20 per cent of the population that made significant gains in their income shares at a time when all other income groups (i.e. 80 per cent of the population) were losing their income shares. Between 1990–91 and 1998–99, the ratio of richest 20 per cent to poorest 40 per cent of the population declined from 2.15 to 2.55. These results are corroborated by Anwar (2005) who noted that the period of 1990s registered slightly increasing magnitude of inequality in Pakistan because the distributional changes allowed richest income groups to increase their relative income shares in 1990s, which were highest in more than 50 years.

We note that urban and rural areas differ in the evolution of inequality. The results suggest that inequality in urban areas of Pakistan was much higher than rural areas. This is not surprising in a country like Pakistan where due to presence of extremely rich and extremely poor households

Changes in Gini Inequality in Pakistan and Urban and Rural Areas

	1990–91	1992–93	1993–94	1996–97	1998–99	2000–01	2005–06
Gini index[a]							
Urban	32.39	35.97	34.00	33.74	39.18	35.16	33.30
Rural	26.71	28.73	29.34	35.12	26.23	24.79	25.41
Overall	29.79	32.11	32.49	33.89	34.27	30.41	30.55
Quintile share[b]							
Q1	8.5%	8.4%	8.2%	8.4%	7.7%	8.5%	8.4%
Q2	12.0%	11.5%	11.3%	11.5%	11.0%	11.9%	11.8%
Q3	15.2%	14.6%	14.3%	14.4%	14.3%	15.1%	15.1%
Q4	20.1%	19.3%	19.1%	18.7%	19.4%	20.0%	20.3%
Q5	44.2%	46.3%	47.1%	47.0%	47.6%	44.5%	44.4%
Ratio of richest 20% to poorest 40% (Q5/(Q1+Q2)	2.15	2.32	2.41	2.36	2.55	2.18	2.20

[a] Gini-coefficient x 100.
[b] Percentage of the total.
Source: Burki, Abid et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010).

Changes in Gini Inequality by Provinces

Year	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan
1990–91	29.70	31.85	23.76	24.86
1992–93	32.61	33.60	27.22	24.83
1993–94	33.38	33.57	24.83	27.81
1996–97	34.78	33.20	28.59	29.01
1998–99	34.78	36.61	28.45	23.33
2001–02	30.04	35.18	23.33	22.09
2005–06	30.39	33.09	25.86	23.54

Source: Burki, Abid et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010).

in the urban areas, incomes and wages are much more diversified. By contrast, most households in rural areas possess uniform skill sets and the bulk of the landowners are either small or very small. It leaves incomes to be relatively more evenly distributed. Whereas inequality in urban areas always remained higher than rural areas, it increased sharply in the first two years, fell from 1992–93 to 1996–97, increased again in 1998–99 and then fell again in 2000–01 and 2005–06. In the rural areas, however, inequality consistently increased from 1990–91 to 1996–97 and then sharply declined over the 1996–97 and 2005–06 period. The increase in inequality in urban areas especially after 1996–97 may be attributed to the implementation of the Structural Adjustment Program in Pakistan. The decline in national inequality after 1996–97 is explained by a sharp decline in inequality in the rural areas and a marginal decline in inequality in urban areas.

The time profile of the measures of inequality for the four provinces can be visualized in Table 4.7 Figure 4.8 where the results based on 1990–91 survey should be interpreted with caution since this survey was not representative at the provincial level. In the net, we find that inequality levels in Punjab and Sindh are much higher than KP and Balochistan. Like the national level trend, inequality in the provinces follows two patterns: it depicts an increasing trend from 1990–91 to 1996–97 and a decreasing trend from 1996–97 to 2005–06.

Source: Burki, Abid et al, *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010), 295.

Table 23.6: The Ten Least Deprived Districts of Pakistan–Panel A

	Index of Multiple Deprivation	Index of Multiple Deprivation	Annual Rate of Change
	2005	1998	[%]
Karachi	20.9	24.6	−2.3
Lahore	29.2	34.3	−2.3
Gujranwala	38.5	45.1	−2.2
Sialkot	40.9	40.3	0.2
Rawalpindi	41.4	41.0	0.1
Gujrat	42.7	46.5	−1.2
Faisalabad	44.2	45.6	−0.4
Peshawar	44.2	50.8	−2.0
Sukkur	44.5	58.0	−3.7
Quetta	46.0	46.0	0.0

The Ten Most Deprived Districts of Pakistan–Panel B

	Index of Multiple Deprivation	Index of Multiple Deprivation	Annual rate of Change
	2005	1998	[%]
Kohistan	71.7	83.0	−2.1
Khuzdar	72.8	79.0	−1.1
Qilla Abdullah	73.9	76.1	−0.4
Jhal Magsi	74.7	79.2	−0.8
Panjgur	75.6	79.2	−0.7
Qilla Saifullah	76.8	76.2	0.1
Zhob	77.1	79.3	−0.4
Kharan	77.6	82.9	−0.9
Awaran	79.8	80.4	−0.1
Musakhel	82.8	89.1	−1.0

Source: Jamal, Haroon and Khan, Amir Jahan, *Indices of Multiple Deprivations 2005*, Research Report 3 (Karachi: Social Policy Development Centre, 2007).

Soon after the independence of East Pakistan, a paper was published in 1974 by Naved Hamid and Akmal Hussain,[11] which examined the extent of regional inequality in what remained of Pakistan. For the authors, capitalist development was 'almost always accompanied by increasing income inequalities in every field and Pakistan's experience shows that of these, regional disparities are potentially the most explosive'.[12] Using Gunnar Myrdal's theory of 'Circular Cumulative Causation' as an adequate explanatory tool, the authors agreed that 'once inequalities are created, the play of market forces normally tends to increase rather than decrease the inequalities between regions. If market forces were allowed to operate, industrial production, commerce, banking, insurance, shipping, etc. would cluster in certain localities and regions, leaving the rest of the country in the state of backwardness'[13] (see Appendix 23.1 for a more extensive explanation). The basic premise of the thesis presented by Naved Hamid and Akmal Hussain was that once regional inequalities emerged, whether due to historical accidents, such as a city developing as a port, or to a region being particularly productive in one or many agricultural commodities, or to government efforts, *it was very likely that inequalities would increase*.

Shahid Kardar offered similar views and gave a number of explanations as to why regional economic disparities have existed in Pakistan in the past.

a) The differences in the growth rates of different regions are primarily because of the differences in the level of development of the different factors of production, level of technology, capital intensity, the productivity of the capital structure, and the degree of complementarity offered by the social environment in which the productive forces are required to operate.
b) The economic disparities are partly the outcome of the pattern of public investment undertaken by the British for their own political and economic interests as colonizers.

Table 23.7
Regional Poverty in Pakistan: 1990–91 to 2005–06

Province/overall	1990–91	1992–93	1993–94	1996–97	1998–99	2000–01	2005–06
Overall	**37.41**	**32.28**	**30.94**	**27.11**	**38.89**	**34.36**	**22.36**
Punjab	40.49	31.07	30.83	26.41	41.31	32.38	18.78
Sindh	27.16	29.34	25.45	19.22	31.10	34.16	21.74
KP	44.09	41.23	38.39	37.64	46.64	41.75	27.57
Balochistan	26.42	34.89	39.64	34.38	28.19	37.36	50.74
Urban Areas	**26.51**	**24.97**	**19.75**	**20.69**	**21.00**	**22.32**	**13.74**
Punjab	28.29	27.72	21.51	21.99	24.39	23.13	12.51
Sindh	22.94	20.29	17.23	17.27	14.24	19.20	11.88
KP	32.14	23.08	22.66	22.41	26.75	29.44	23.98
Balochistan	21.99	35.56	21.04	23.24	24.94	26.75	32.18
Rural Areas	**42.51**	**38.18**	**35.73**	**35.47**	**46.33**	**39.27**	**26.73**
Punjab	45.51	32.33	34.52	32.62	48.17	36.13	21.76
Sindh	31.17	36.53	32.93	36.51	44.02	43.73	31.38
Khyber Pakhtunkhwa	46.49	43.76	41.10	42.82	50.06	43.73	28.24
Balochistan	27.48	34.79	42.00	40.42	28.67	39.59	56.48

Source: Burki, Abid et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010).

c) Regional differences can be narrowed and spatial imbalances corrected by the transfer of resources from the centre by setting up public sector projects in backward areas, through a credit policy for industry locating in backward regions, through other investment in physical and social infrastructure or by indirectly making private investment cheaper in the relatively backward areas. The policy measures introduced, however, to bring about balanced regional growth have been ineffective in arresting the increasing disparities in the income of different provinces. Per capita plan outlays did not reflect the professed desire to achieve regional balanced development. Consequently, even the savings of less well-off regions were invested in the relatively industrialized regions, given the advantages of external economies and the resultant high returns.

d) Development of different regions has proceeded in a lopsided manner—the distribution of industrial growth, in particular, is horribly skewed. Consequently, one of the main advantages of industrialization, the potential for creating backward and forward linkages, was lost. Most industrial licences were issued and credit was provided to the industries that were locating in the provided developed area—which had skilled labour and provided specialized and auxiliary inter-industrial linkages and engineering and repair and maintenance workshops.

e) Private investment demonstrated its natural tendency to flow into the already developed areas, as such a move ensured higher marginal returns.

f) The poorer areas have shown smaller credit absorptive capacity because of the low level of infrastructural development.

Figure 23.1: Poverty Headcount in Urban Pakistan: 1990–91 to 2005–06

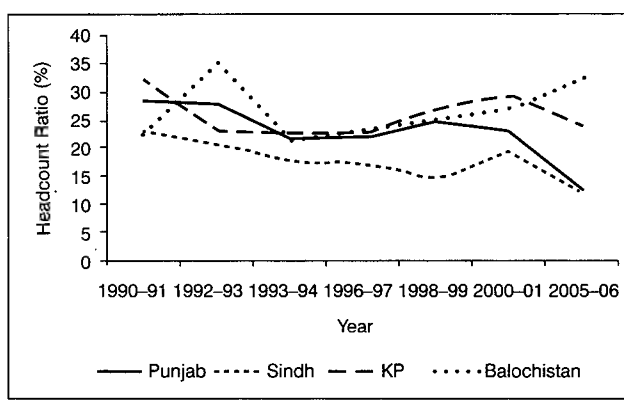
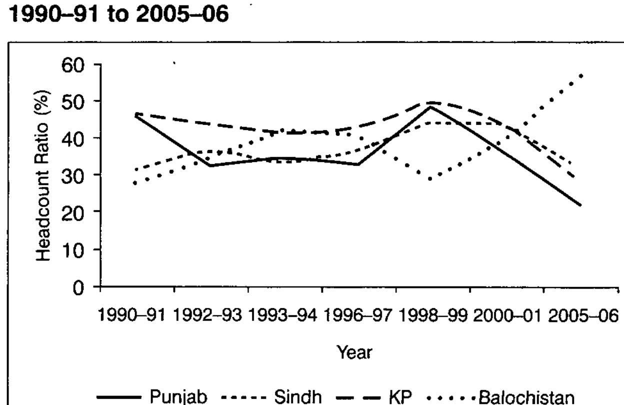


Figure 23.2: Poverty Headcount in Rural Pakistan: 1990–91 to 2005–06



Box 23.3

Spatial Concentration of Economic Activity

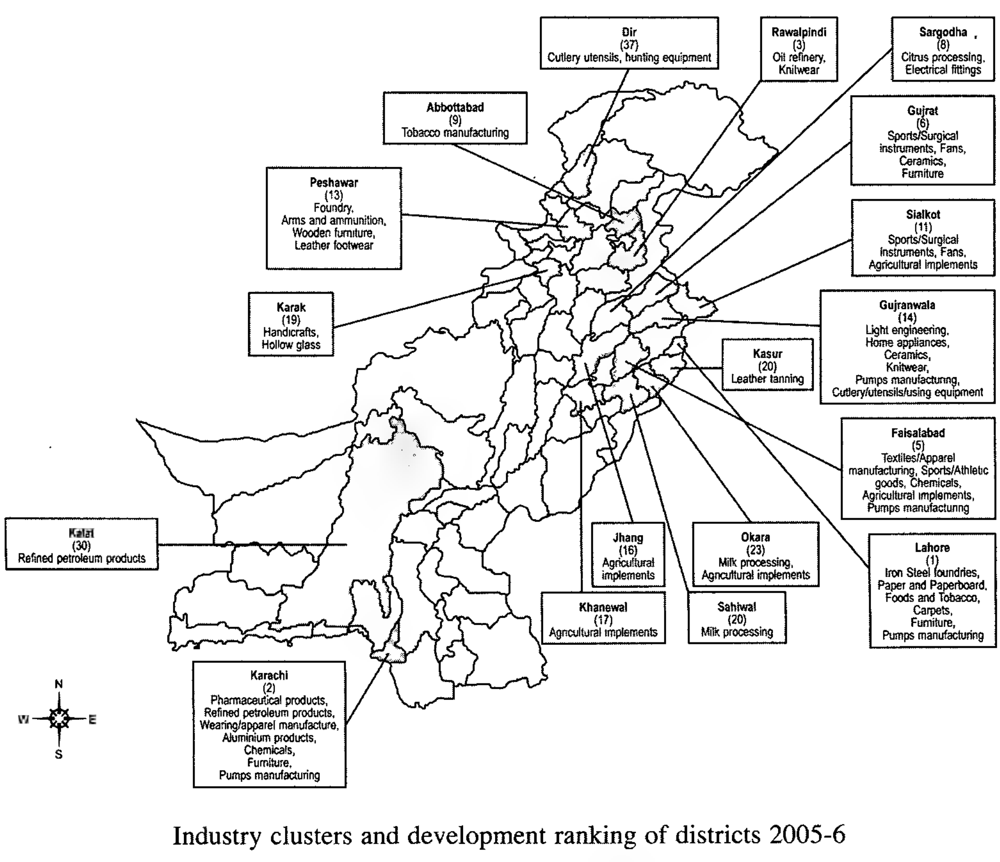
The most striking feature of economic activity in Pakistan is the geographic concentration (or clustering) and location of factors of production in few cities, including unequal spatial distribution of income, poverty, education, health and physical infrastructure, among others. The concentration of economic activity in few metropolitan areas symbolizes the coexistence of development and underdevelopment within and between regions. Another manifestation of the problem is that the share of urban population has dramatically increased since 1960. While there are a number of theories that explain why geographical concentration of economic activity takes place, little is known about the factors that drive internal economic geography of developing countries, what course this inequality takes, and whether this inequality is socially desirable. . . . [274]

. . . While the empirical evidence on spatial inequality in developed countries may have immense value, the patterns of industrial development, market efficiency and political and institutional histories in countries like Pakistan are fundamentally different from the developed countries. When regional and spatial divisions align with political and ethnic pressures they give rise to political and social instability in the country. But despite obvious policy concerns there has been no systematic evidence on regional and spatial mapping. . . . [278]

. . . Knowledge about the regional location of the poor is essential if the government is to adopt a sound industrial development policy that is more effective in attacking poverty. The distinction must be made between poverty and inequality. Poverty relates to absolute living standards of a section of the society in a country. Inequality is concerned about relative incomes or standards of livings vis-à-vis the whole society. Both poverty and inequality have significant regional dimensions in developing countries. Accurate answers to two questions are critical in guiding future policy that aims at faster convergence in living standards between most deprived and least deprived regions. One, how much poverty (and inequality) is there in Pakistan, across provinces and across urban and rural dimensions? And two, what are the trends in poverty (and inequality) over the last two decades? Unfortunately, the answers to these questions are blurred by inconsistent estimates on poverty (and to some extent on inequality) reported in the existing literature. [285]

. . . we can clearly see that investment in social infrastructure is highly concentrated in metropolitan cities, big cities and their surrounding districts while districts located away from these urban demand centres (e.g. southern Punjab, interior of Sindh and remotely located districts in Khyber Pakhtunkhwa and Balochistan) are lagging behind.

Source: Burki, Abid et al, *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010).



Industry clusters and development ranking of districts 2005-6

Box 23.4

The Relationship Between Inequality and Poverty in Pakistan

Because economic inequality and poverty are interrelated concepts, they are often studied together. Theoretically, inequality tends to constrain availability of resources at the bottom end of the population distribution making them more likely to be poor. However, this is an empirical question which may or may not be true in Pakistan. Some earlier studies confirm the importance of inequality in poverty alleviation exercise.

Our evidence suggests that significant changes in income inequality and poverty have been observed in the country from 1990–91 to 2005–06. However, the link between growth, inequality and poverty is not very well understood. Even though Pakistan enjoyed low to moderate growth rates in per capita income in the 1990s, its progress against poverty has been affected by the cyclical nature of inequality. Based on our calculations from seven household surveys, Figure 5.1 shows that inequality was procyclical from 1990–91 to 1998–99 as Gini coefficient increased with moderate growth in per capita income.

Rising inequality with income growth did not exacerbate the prospects of poverty alleviation during this period because the income share of the poorest 20 per cent remained unchanged until 1996–97. This is revealed in Figure 5.2 which shows that the number of poor people kept on decreasing from 1990–91 to 1996–97. The largest increase in poverty took place in 1998–99 at a time when per capita GDP growth slowed down to less than 1 per cent due to economic sanctions imposed on Pakistan following the nuclear detonation leading to worsening of the income share of bottom 20 per cent population falling below 8 per cent for the first time in eight years. Inequality became countercyclical after 1998–99 as Gini coefficient sharply declined while per capita income rapidly increased.

Falling inequality associated with rapid income growth significantly improved the positive effects of income growth on poverty alleviation. As shown in Figure 5.2, low inequality augmented the progress against poverty as the number of poor fell from close to 50 million to a little more than 30 million, or about 40 per cent fall in poverty. These results suggest that inequality does matter for poverty reduction.

Further evidence confirms that inequality is a constraint on poverty alleviation in Pakistan because the progress against poverty suffers from worsening distribution of income. This is shown in Figure 5.3 [the figure below] where the solid line shows poverty with actual Gini inequality while the broken line depicts the number of poor holding Gini inequality as constant. We project that had Pakistan maintained the same income distribution throughout the 1990s as it was in 1990–91 (i.e. 29.79 per cent), the increase in the number of poor would have been much smaller, especially between 1993–94 and 1998–99. We note that even small inequality changes experienced by Pakistan made considerable impact on poverty.

Figure 5.1: Distribution of Equality and Per Capita Income

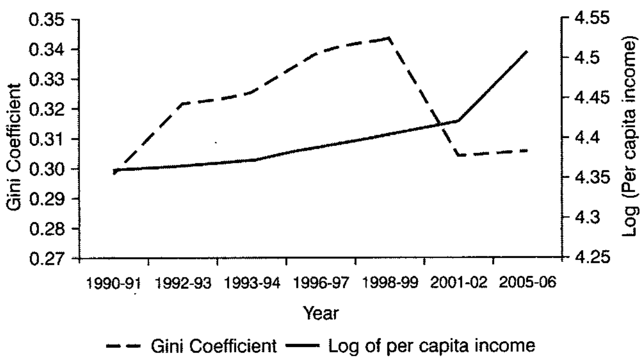


Figure 5.2: Distribution of Poverty and Per Capita Income

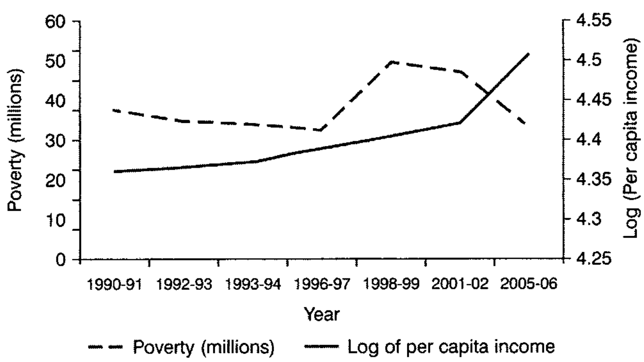
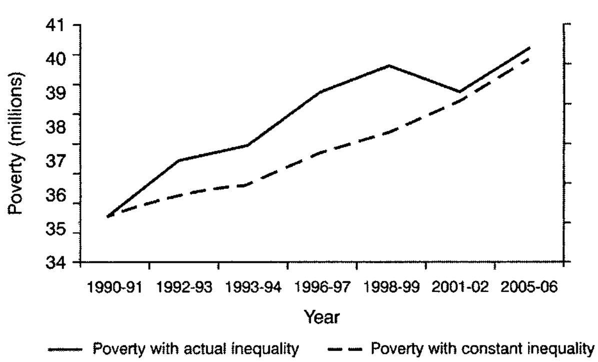


Figure 5.3: The effect of inequality on poverty in Pakistan, 1990–91 to 2005–06



Source: Burki, Abid et al, *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010), 350–51.

g) Financial assistance from the centre has not, by operating as a balancing factor, helped in neutralizing the differences that existed in development potential for historical reasons. Regional disparities cannot be removed by simply making financial resources available.[14]

A third study, which has examined the process of regional/provincial imbalances over time using a political economy approach, while accepting the earlier positions of Naved Hamid and Akmal Hussain, and of Shahid Kardar, argued that much of their analysis was useful for the earlier phases of capitalist development in Pakistan. It maintained that, towards the end of the 1980s and especially in the 1990s, 'the development of productive forces has brought together, rather than disintegrated, the people of Pakistan . . . and what we are seeing for the first time, is the birth of the *Pakistani Nation*'.[15] This view holds that:

> There has been a very marked trend of the coming together of the various regions of Pakistan. A greater integration, even of 'culture', the loaded term that it is, has been observed. While capitalist development acts as a force which results in fissiparous tendencies, recent trends in Pakistan suggest that there has been a process of integration, and assimilation. After the initial distancing when capitalism is in its earlier phases [as argued by Naved Hamid and Akmal Hussain], with relatively more advanced capitalism, the demand by newly emergent regional (nationalist) groups is directed towards gaining more spoils from the centre. [Hence] their nature to use their special position as regionalists to acquire accommodation at the centre. This has been the pattern observed in Pakistan over the last few years.[16]

While differences in economic and social development will continue to exist, and possibly worsen in a capitalist economy like Pakistan, it is important to understand why they exist in the first place and how some sort of balance through political and policy initiative can be maintained. Many of the earlier chapters of this book—especially those on agriculture and industry—explain how inequalities emerged, some for historical and accidental reasons, others through conscious government policy interventions. For example, it is improbable to assume that the Green Revolution in agriculture could have taken place anywhere else but in the central region of the Punjab; Balochistan, Sindh, the NWFP, and much of the rest of the Punjab were not suited to the highly water-dependent technology of the agricultural package. Karachi developed as Pakistan's leading industrial and commercial city mainly because it was a port, and was the capital of Pakistan for many years. The NWFP has shown prosperity on account of substantial remittances from the Gulf states, and because of aid and donor money which came into the province following the 1979 and 2001 invasions of Afghanistan. The provincial capitals have developed far in excess of the rest of their provinces because they are the largest cities, have some industry and trade, and have the presence of a huge government machine. District headquarters have similar advantages. Moreover, despite the government's attempts to promote underdeveloped and backward regions by giving them tax breaks and other incentives, private enterprise will not shift there as these places lack skilled labour, infrastructure, and a business 'culture'.

This section has dealt with an emotional and politically sensitive issue. Given Pakistan's history, some area or group of people has always felt discriminated against. Many of these groups have been organized and militant and have been able to express their resentment and concern; others have had to live with discrimination without being in a position to voice their protest. It is inevitable that regional imbalances will continue to exist in Pakistan, and some districts and some provinces will always be richer and more developed than others. Government intervention can help address these gaps, but in a predominantly market-oriented economy, regional inequalities will persist—see Boxes 23.3, 23.4 and 23.5.

23.2 Regional Inequalities: Agro-Climatic Zones[17]

The section above presents a view of inequalities and development differences at the district and province level. Both districts and provinces are administrative units created by governments and can be easily rearranged, as we have seen in the context of Pakistan. Such units allow us to make some comparison regarding the level of development, and accusations or claims of discrimination or neglect, are often made on the basis of these differences. The work by Sohail J. Malik provides us very different regional units of analysis which are not man-made or based on administrative interventions. Such units, based on agricultural production and climatic and geographic boundaries are less mutable and allow a longer time frame of comparative analysis. However, while helpful in highlighting differences, corrective mechansims might be a little more difficult to address, since many of these climatic units overlap with administrative boundaries. Governments do not work within agro-climatic units or boundaries, but create their own units of analysis. Nevertheless, these agro-climatic zones do provide a different and useful unit of analysis.

Figure 23.3 and the listing of districts in Table 23.8 provide the nine agro-climatic zones used for analysis by Sohail Malik. The rationale of the zones is that while wheat is sown in the winter (*rabi*) season in almost all parts of Pakistan, he uses the main *kharif* (summer or monsoon) crops of irrigated rice and cotton to differentiate between different zones. Since Balochistan or Khyber Pakhtunkhwa do not have much variation in cropping patters, they are not sub-divided and constitute whole zones in this classification.

Box 23.5

Economic Growth and Distribution

[The] discussion of macroeconomic aggregates . . . suggests that real per capita income (GDI) grew by 4.4 per cent over the three years (2007–08 to 2010–11) but that per capita growth in private consumption was much higher at 18 per cent as real investment declined sharply. These numbers are, however, higher than reported by the results of the annual Household Integrated Economic Survey (HIES) and the developments in the labour market. The former indicates that real income per household increased cumulatively by 2.9 per cent over the three years 2007–08 to 2010–11 (see Table 2.10) and real consumption grew by 4.3 per cent over the same period (see Table 2.11). At the same time, the slow growth in employment of 2.5 per cent over the same period registered by the labour surveys and fragmented data on real wage rates suggest rising unemployment, particularly among the youth and decline in real wages over the last three years.

This discrepancy needs urgent attention of policymakers, analysts and academics. A plausible explanation is that income distribution is worsening sharply because of high level corruption, economic rent seeking, and continued large inequalities of asset holdings, especially of land, and the high end incomes and consumption are not adequately captured in HIES as well as in the reported income distribution data.

It could also be that the sharp rise in rural incomes during the last few years is not adequately captured in the HIES surveys. The growth in rural incomes of 1.2 per cent over the last three years shown in Table 2.10 does seem very much on the low side. This could also reflect the negative impact of the devastating floods in 2010–11.

The apparent statistical inconsistencies need to be explored seriously and data sets reconciled as far as possible. But there is enough indirect evidence to suggest that the low income and middle income groups have not shared adequately in the income growth that has taken place during the last three years. High inflation generally, and sharp rise in food and energy prices have hit most households very hard. Between 2007 and 2010 the nominal wage increases have generally been well below the rise in general price level over the three years.

Even though we believe that the HIES surveys understate income inequality, it is noteworthy that they report that inequality has continued to increase during the last three years. Overall, the lowest two quintiles of households have suffered a drop in their real incomes, while significant increases have been recorded in the case of upper income households. This also implies that the incidence of poverty must have increased during the last three years.

Given the stagnation or fall in real household incomes for the bottom 40 per cent income receivers, declining levels of nutrition and food security, rising unemployment and underemployment and deterioration in the quality of public services, it is not surprising that a high and increasing proportion of households have reported dissatisfaction with their economic situation (compared to the year before the survey). According to PSLM, two years ago this percentage was 33 per cent which has increased to 43 per cent in 2010–11, while the percentage who have reported an improvement has fallen from 22 to 17 per cent.

Table 2.10
Change in Real Household Income

(Rs. per Month)

	2007–08	2010–11		Percentage
		Nominal	Real*	Change
Average	**14456**	**21785**	**14875**	**2.9**
lowest 20%	7812	11386	7775	–0.5
next 20%	9910	14274	9747	–1.6
next 20%	11172	16841	11499	2.9
next 20%	13227	20784	14192	7.3
highest 20%	24659	37728	25762	4.5
Rural	12626	18713	12777	1.2
Urban	17970	27664	18890	5.1
Punjab	14601	22859	15609	6.9
Sindh	14819	20606	14070	–5.1
KPK	14044	20130	13745	–2.1
Balochistan	11375	18534	12656	11.3

* Nominal income has been deflated by the Consumer Prince Index with the base year of 2007–08. The index value is 1.4645.

Source: Pakistan Economic Survey (Islamabad: various issues)

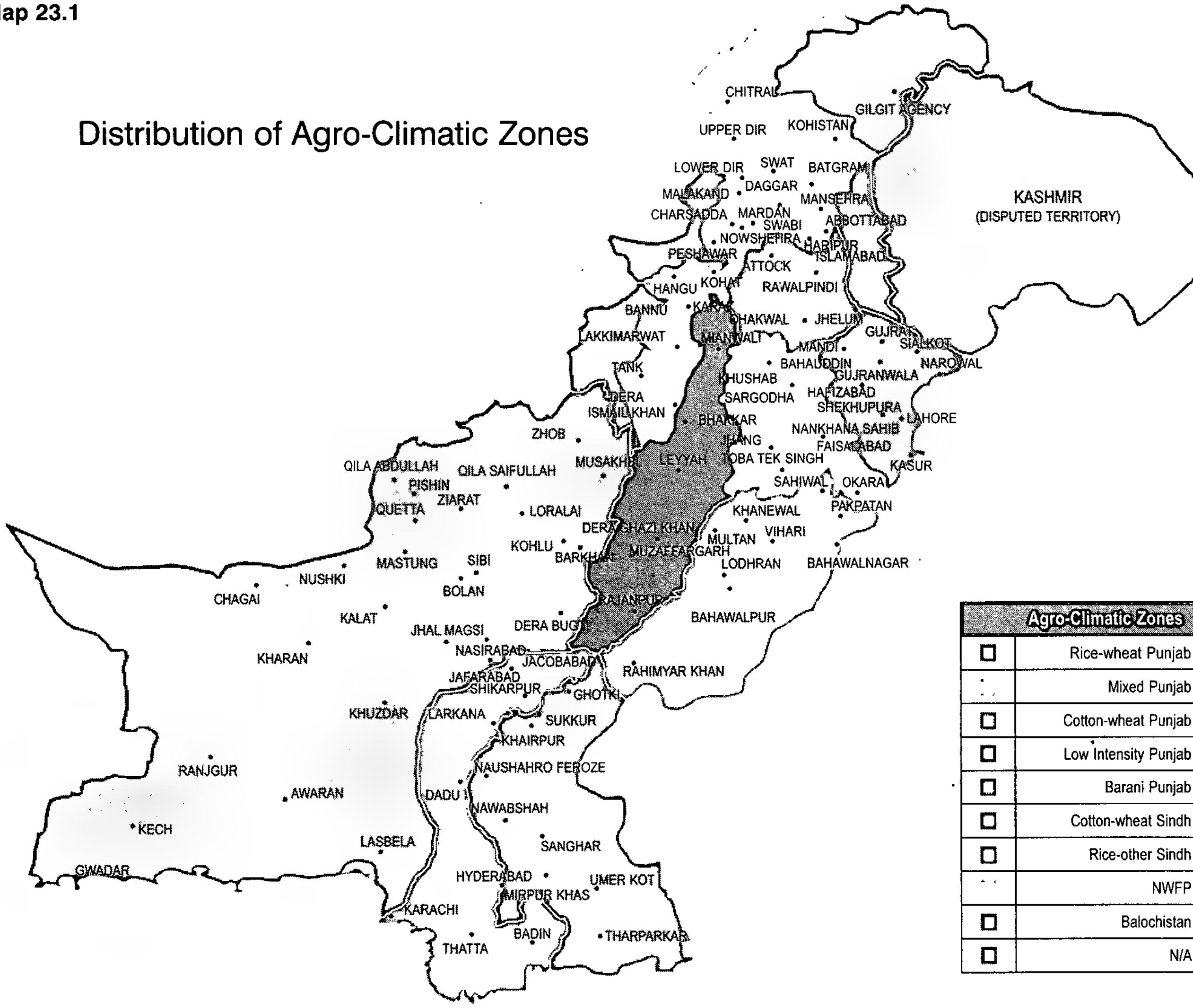
Table 2.11
Change in Real Consumption Expenditure by Households

(Rs. per Month)

	2007–08	2010–11		Percentage
		Nominal	Real	Change
Average	**12660**	**19336**	**13203**	**4.3**
lowest 20%	7485	11503	7855	4.9
next 20%	9209	14268	9743	5.8
next 20%	10445	16537	11292	8.1
next 20%	12235	19014	12983	6.1
highest 20%	19866	29902	20418	2.8
Rural	11128	16919	11552	3.8
Urban	15601	23595	16360	4.9
Punjab	12611	19070	13022	3.3
Sindh	12718	20103	13727	–5.1
KPK	13472	19577	13368	–0.8
Balochistan	10656	18183	12416	14.0

Source: Institute of Public Policy, *Fifth Annual Report 2012: The State of the Economy—The Punjab Story* (Lahore: Institute of Public Policy, 2012), 31–32.

Map 23.1



In Table 23.9, one can see the difference in poverty levels according to these agro-climatic zones. Table 23.9 also shows that Barani Punjab has the lowest poverty in Pakistan, based on the Official Povety Line—see Chapter 22 for its calculation—and, not surprisingly, Balochistan has the highest proportion of its population under the poverty line—see also Figure 23.3. Sohail Malik's work also provides large amounts of information on the basis of the agro-climatic zones, which allow an assessment of the rural economy. Table 23.10 shows the distribution of income from different sources across the zones, and as highlighted in Chapter 5 (Agriculture), shows that as much as 60 per cent of *total rural incomes* accrue in the non-agricultural sector, with KPK having 83 per cent of its *total rural income emanating from the non-agricultural sector*. Of the nine agri-climatic zones, in six of them, *non-agricultural incomes are the largest source of income*. Rural areas of Pakistan now depend far more on non-agricultural incomes, which emanate from livestock, 'non-agricultural business activity', and domestic and increasingly, international, remittances, particularly in some regions, as Tables 23.10 and 23.11 show.

23.3 The Case of Karachi: Economic, Social, and Demographic Aspects

From all accounts, Karachi seems to be the most developed region of Pakistan. It stands out in many categories and deserves a separate sub-section of its own. Here we examine the current and future prospects for Karachi as an economic, social and demographic entity, and also looking at some political considerations. The data, analysis, and projections are based on large sets of data, published reports, and government statistics all available in the public domain, with most of it published, as well as academic and scholarly articles written on Karachi—see References for a list. In many cases, the analysis has been constrained by the nature and limits of the data, as some of it is outdated. Nevertheless, the existing data does allow us to evaluate the socio-economic and demographic status of Karachi and also allows some projections into the future. (All references to Karachi unless otherwise stated, are to be read as Karachi Division comprising of the five old districts of Karachi, viz. South, North, West, East, and Malir.)

Table 23.8: Classification of Districts into Agro-Climatic Zones

Agro-Climatic Zones	Districts	
Rice-Wheat Punjab	Gujranwala Sialkot Mandi Bahauddin Lahore Sheikhupura	Gujrat Hafizabad Narowal Kasur
Mixed Punjab	Sargodha Faisalabad Toba Tek Singh	Khushab Jhang Okara
Cotton-Wheat Punjab	Vihari Multan Pakpattan Bahawalpur Rahimyar Khan	Sahiwal Khanewal Lodhran Bahawalnagar
Low Intensity Punjab	Mianwali Dera Ghazi Khan Muzaffargarh	Bhakkar Rajanpur Dera Ismail Khan
Barani Punjab	Islamabad Rawalpindi Chakwal	Attock Jhelum
Cotton-Wheat Sindh	Khairpur Nawabshah Ghotki Tharparkar Mirpur Khas	Sukkur Nowshero Feroze Hyderabad Sanghar Tando Mohammad Khan
Rice-Other Sindh	Jacobabad Dadu Thatta Karachi South West Karachi Larkana	Shikarpur Badin Karachi East Central Karachi Malir
NWFP	Lower Dir Buner Nowshera Kohat Hangu Mansehra Haripur Kohistan Swabi Lakki Marwat Malakand	Chitral Charsadda Peshawar Karak Tank Abbottabad Batgram Mardan Bannu Upper Dir
Balochistan	Quetta Sibi Makran Nasirabad Qila Abdullah Khuzdar Mastung Turbat	Kalat Zhob Pishin Ziarat Lasbela Punjgur Kharan

Source: Innovative Development Strategies (Pvt.) *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009).

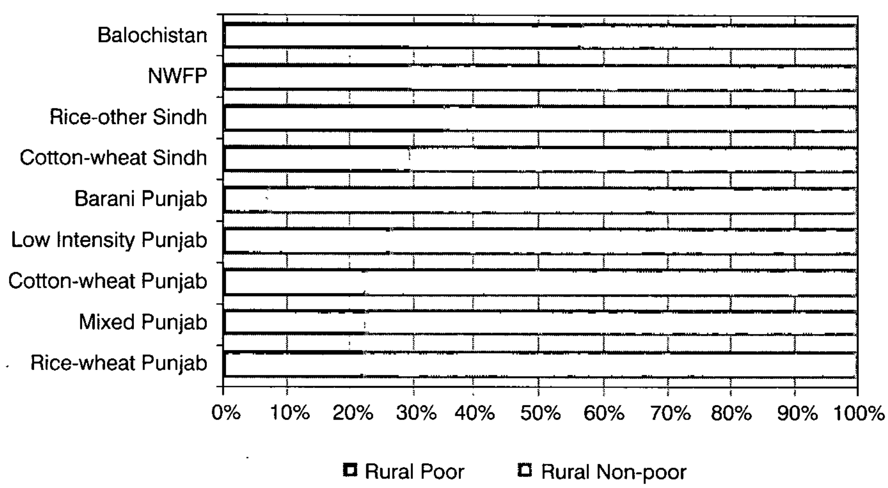
Table 23.9: Rural-Urban Poverty by Agro-Climatic Zone (2005–06)

(% of population)

	Rural		Urban		Total	
	Poor	Non-poor	Poor	Non-poor	Poor	Non-poor
Rice-Wheat Punjab	22.2	77.8	11.4	88.6	18.4	81.6
Mixed Punjab	22.6	77.4	6.0	94.0	19.6	80.4
Cotton-Wheat Punjab	22.6	77.4	13.3	86.7	21.8	78.2
Low Intensity Punjab	26.1	73.9	16.7	83.3	25.0	75.0
Barani Punjab	7.2	92.8	1.5	98.5	5.5	94.5
Cotton-Wheat Sindh	29.6	70.4	11.5	88.5	26.5	73.5
Rice-Other Sindh	35.1	64.9	4.9	95.1	19.0	81.0
NWFP	29.2	70.8	22.7	77.3	28.2	71.8
Balochistan	56.6	43.4	32.4	67.6	50.9	49.1
Other Punjab Urban	N/A	N/A	15.9	84.1	15.9	84.1
Other Sindh Urban	N/A	N/A	20.4	79.6	20.4	79.6
Total	27.0	73.0	13.1	86.9	22.3	77.7

Source: Innovative Development Strategies (Pvt.) *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009).

Figure 23.3: Rural Economic Status by Agro-Climatic Zone: 2005–06



23.3.1 Economic and Social Aspects

Karachi is the most developed economic and social administrative entity (District/Division) in Pakistan. As we show in Section 23.1 above, in almost every single economic and social indicator, it tops the list of Pakistan's 106 districts. Although in a few cases, it seems that some districts have a better social or economic profile, there is no ambiguity about the fact that Karachi is the most advanced, most economically productive, and with the best social indicators in Pakistan.

Some examples are as follows:

a) In terms of *literacy* in Pakistan, a key indicator for development, human development and for access in the information age, based on the 1998 Census, Karachi had the second highest literacy ratio in Pakistan after Islamabad (72.4 per cent) with 72.2 per cent, followed by Rawalpindi (70.4 per cent). However, Karachi District Central had the highest literacy ratio in Pakistan, of 76 per cent. Moreover, in the case of female literacy, Karachi Division had much higher literacy than any other District in Pakistan, 63.94 per cent, with Karachi Central having a literacy ratio of 73.9 per cent and Karachi East 70.1 per cent. In fact, Karachi South had the third highest female literacy ratio in Pakistan (62.7 per cent). *Female literacy is one of the most important human development indicators and inputs into the quality of life of its people. Karachi had a huge advantage over the rest of Pakistan in this critical category.*[18] It is very probable that over the 15 years since the 1998 Census, these numbers for Karachi have improved even further.

b) In academic research which has ranked all the districts of Pakistan based on a composite Human Development Index (HDI) composed of literacy rates, enrolment rates, the immunization ratio, infant survival rates, and the real GDP per capita, Karachi has the 5th highest HDI rank, from 91 Districts for which this calculation

Table 23.10: Total Rural Income by Agro-Climatic Zone

(All Figures in Rs.)

	Total Crop Income		Total Non-agricultural Income		Total Income from Livestock		Total Net Transfers	
	Poor	Non-poor	Poor	Non-poor	Poor	Non-poor	Poor	Non-poor
Rice-Wheat Punjab	6,361 (6361)	88,593 (52,344)	11,974 (11,953)	191,649 (75,624)	3,210 (3,210)	26,006 (16,601)	2,119 (2,118)	42,371 (14,124)
Mixed Punjab	6,935 (6,691)	86,356 (37,329)	15,861 (15,202)	96,982 (62,754)	2,724 (2,717)	17,795 (6,626)	1,866 (1,869)	11,627 (9,496)
Cotton-Wheat Punjab	17,894 (17,731)	158,335 (85,147)	16,408 (16,346)	135,643 (89,317)	2,616 (2,641)	23,592 (13,402)	1,913 (1,909)	12,284 (5,403)
Low Intensity Punjab	8,624 (8,569)	37,077 (27,561)	19,420 (19,096)	68,245 (43,310)	1,560 (1,557)	9,394 (6,454)	1,739 (1,739)	9,795 (8,417)
Banani Punjab	66 (66)	8,691 (5,905)	365 (365)	33,737 (15,435)	129 (129)	3,976 (2,630)	175 (175)	11,992 (7,138)
Cotton-Wheat Sindh	11,707 (11,649)	48,084 (42,305)	5,958 (5,958)	75,248 (26,213)	1,770 (1,748)	5,009 (4,603)	–101 (–100)	–398 (–263)
Rice-Other Sindh	19,884 (58,857)	34,962 (28,207)	6,462 (6,462)	21,148 (17,417)	3,223 (3,186)	5,821 (5,066)	–101 (–99)	210 (444)
NWFP	6,995 (6,993)	25,307 (17,994)	23,559 (23,526)	419,356 (117,791)	3,743 (3,743)	12,248 (9,440)	7,561 (7,514)	37,847 (24,762)
Balochistan	4,321 (4,218)	15,158 (12,293)	5,070 (5,035)	14,454 (12,506)	590 (588)	1,049 (947)	233 (230)	1,291 (946)
Total	82,785 (81,133)	502,562 (309,085)	105,078 (103,944)	1,056,461 (460,367)	19,564 (19,521)	104,926 (69,768)	15,402 (15,350)	127,081 (70,468)

Note: Aggregates for the MF market are given in parentheses.
Source: Innovative Development Strategies (Pvt.) *Profiling Pakistan's Rural Economy for Microfinance*, Pakistan Microfinance Network, Islamabad, 2009.

has been made.[19] (It is worth pointing out that with the methodology applied to calculate the HDI rank, there are some districts which have a very sparse population but do better than Karachi. For example, those districts which do better than Karachi according to this ranking are, in order of highest first: Jhelum, Ziarat, Haripur and Shiekhupura.)

c) A study by S. A. Wasti and M. U. Siddiqui,[20] which defined the rank ordering of 101 districts of Pakistan according to the level of socio–economic development using various indicators and statistical techniques (weighted factor score, taxonomic distance, Z-sum), ranked Karachi as 1st, 2nd and 1st respectively, and followed by Lahore 2nd, 1st and 2nd, Peshawar 3rd, 4th, and 4th respectively. Haroon Jamal and A. J. Khan,[21] computed and ranked the districts of Pakistan according to an index of multiple deprivation and established that *Karachi is the least deprived district of Pakistan*, followed by Lahore, Gujranwala, Sialkot, Rawalpindi, Gujrat, Faisalabad, Peshawar, Sukkur and Quetta. Haroon Jamal[22] predicted the district-wise incidence of poverty using the data of the Household Income and Expenditure Survey (HIES) Reports. *Karachi is said to have the least incidence of poverty as compared to the other districts of Sindh*, i.e. overall 9.5 per cent with a composition of urban 8.35 per cent and rural 26.15 per cent.

d) In terms of the indicators used above, overall literacy, female literacy and HDI rank, it is worth comparing Karachi with the rest of Sindh. In terms of overall male and female literacy ratios, *Karachi's literacy ratio is significantly higher than that of the next district in Sindh*, Sukkur, which has a male and female literacy ratio of 46.46 per cent. However, it is in the case of female literacy where the difference between Karachi and the rest of Sindh is most striking. *Karachi's female literacy ratio is almost double that of the next best district*, Hyderabad, which has a female literacy ratio of only 35 per cent. However, this is expected to be higher if we only examine the urban part of district Hyderabad. This also has important ramifications for the political considerations regarding Karachi District.

e) In terms of the HDI statistics and rank, while Karachi was ranked 5 from 91, the next Sindh district was Dadu, ranked 21, and Hyderabad 23. Clearly, in terms of HDI, Karachi has much better facilities and hence development indicators than the rest of Sindh.

Table 23.11: Percentage of Households Receiving Remittances

	Domestic		Foreign	
	Poor	Non-poor	Poor	Non-poor
Rice-Wheat Punjab	9.4	19.4	1.2	13.6
Mixed Punjab	13.3	22.4	0.5	4.8
Cotton-Wheat Punjab	11.1	20.8	0.4	2.9
Low Intensity Punjab	11.9	28.4	0.7	5.3
Barani Punjab	17.4	23.2	0.0	5.1
Cotton-Wheat Sindh	0.0	1.0	0.0	0.1
Rice-Other Sindh	0.4	0.6	0.7	1.7
NWFP	20.7	29.8	6.8	14.8
Balochistan	0.3	3.1	0.9	2.1
Total	9.4	19.1	1.7	6.7

Average Annual Inflow of Remittances per Household

(PKR per household [HH])

	Domestic		Foreign	
	Poor	Non-poor	Poor	Non-poor
Rice-Wheat Punjab	37,838	41,454	45,526	158,355
Mixed Punjab	29,652	42,208	54,000	98,808
Cotton-Wheat Punjab	23,215	42,133	45,220	105,887
Low Intensity Punjab	31,992	37,736	47,626	81,570
Barani Punjab	32,280	50,564	0	88,380
Cotton-Wheat Sindh	12,000	28,316	0	34,429
Rice-Other Sindh	12,000	37,231	29,862	80,567
NWFP	42,690	56,446	70,778	119,128
Balochistan	42,000	66,709	73,129	114,354
Total	33,772	45,857	60,562	124,530

Source: Innovative Development Strategies (Pvt.) *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009).

23.3.2 Revenue Collection

It is not surprising that Karachi dominates much of the revenue collection statistics of Pakistan, and completely dominates the revenue collection statistics of Sindh. Much of Pakistan's economic, manufacturing, services and other related production and value addition activity takes place in Karachi. Hence, Karachi would dominate this figure. What might be surprising, is the extent and nature of that scale. Some tables and commentary below, explain this further.

Table 23.12 shows that in terms of Direct Taxes, Karachi contributes *more than 35 per cent of all Pakistan's taxes. However, the share of the Direct Taxes and revenue collection in Sindh, Karachi contributes almost 96 per cent of the total Sindh contribution*. Sindh, excluding Karachi, contributes a little over 4 per cent. Since Karachi is the main port in Pakistan, it is not surprising that it contributes the largest amount of import duties and related import taxes. However, if one looks at the Sales Tax collected, which is a consumption tax, this will give an indication of the nature of economic activity and of the consumer market in Karachi compared to the rest of Pakistan and compared to Sindh. The revenue collected from the Sales Taxes are a good proxy for economic activity.

Table 23.12 and Table 23.13 show that Karachi provides around 35 per cent of total Sales Tax collected for all of Pakistan, and 94 per cent is collected from the province of Sindh. The rest of the Sindh province excluding Karachi provides a mere 6 per cent of the province's Sales Tax.

Moreover, in terms of Karachi's share to Sindh's Provincial Excise Duty and Taxes Recovered across the Province, Karachi provided 88.76 per cent of Sindh's collection in 2007/08, which had risen to 90.13 per cent in 2008/09, the last year for which data is available.

Expenditure and Allocations

According to the allocations in respect of Provincial Annual Development Plan 2008–09, out of the Annual Development Plan of size of Rs. 28,703.204 million, Rs. 8,094.488 million was allocated to Karachi on account of the Provincial Annual Development Plan 2008–09 which amount to 28.2 per cent, which was highest amongst the 23 districts of Sindh. A Budget of Rs. 14,713.03 million was exclusively set aside for major development plan and works. The budget of the City Districts Government of Karachi (CDGK) shows an excess of receipts over expenditures i.e. surplus of Rs. 02.82 million. Cumulative receipts amount to Rs. 70,794.42 million and expenditures summed to Rs. 70,691.60 million. The development schemes of CDGK completed by the ended of June 2011 amounted to Rs. 1,860.44 million.

The volume of the Federal Government Public Sector Development Programme (PSDP) 2008–09 summed to Rs. 24,957.84 billion and the share of Karachi amounts to Rs. 2,954.01 million, or 11.84 per cent compared to rest of districts of Sindh Rs. 22,003.83 million, 88.16 per cent.

23.3.3 An Economic Appraisal of Karachi

Given the desire to have more provinces in Pakistan, arguments have been made about making Karachi into a province on its own accord. While there are serious political factors which would inhibit such a move, it is worth examining the economic viability of such an entity, if it were to be created. From the preliminary analysis presented above, it seems clear, using limited data conducting static and non-dynamic analysis. i.e. not considering *what would happen—the repercussions*—if Karachi was made a separate entity, a province, for example, that Karachi is likely to be better off in terms of economic conditions. This statement is clearly limited and comes with a lot of 'ifs and buts', but on the surface it seems that since Karachi contributes 95 per cent of the revenues collected from Sindh, if these were allocated to Karachi and the money stayed in Karachi, it would have a major positive impact on Karachi. This would be the case, especially if the revenue was kept in Karachi, or at least the major share was kept in Karachi, and Karachi would not need any additional federal government assistance or funding. Under a redefined and negotiated agreement with the federal government, with much of the self-generated

Table 23.12: Revenue Collection 2004–09

REVENUE COLLECTION: Direct Taxes

Provinces and Regions	2004–05	2005–06	2006–07	2007–08	2008–09
	%				
Punjab	36.23	37.51	38.46	39.68	40.15
Islamabad	19.83	21.26	22.04	20.10	20.49
Sindh Including Karachi	39.69	37.68	37.70	38.23	37.04
Sindh Excluding Karachi	1.33	1.44	1.25	1.34	1.51
Karachi	**38.36**	**36.24**	**36.45**	**36.89**	**35.54**
KPK	3.46	2.83	1.21	1.35	1.51
Balochistan	0.79	0.72	0.59	0.63	0.81
Pakistan Including Karachi	100.00	100.00	100.00	100.00	100.00
Pakistan Excluding Karachi	61.64	63.76	63.55	63.11	64.46
Share of Karachi in Revenue collection in Sindh	96.65	96.18	96.68	96.50	95.93
Share of Sindh excluding Karachi Revenue collection in Sindh	3.35	3.82	3.32	3.50	4.07

Table 23.13: Sales Tax Collected 2004–09

REVENUE COLLECTION and SALES TAX ON DOMESTIC

Provinces and Regions	2004–05	2005–06	2006–07	2007–08	2008–09
	%				
Punjab	65.68	67.07	68.86	46.70	24.05
Islamabad	0.0	0.0	0.0	18.3	36.9
Sindh Including Karachi	30.44	29.17	27.27	32.05	36.98
Sindh Excluding Karachi	3.03	3.27	3.39	2.56	2.13
Karachi	**27.41**	**25.90**	**23.88**	**29.49**	**34.85**
KPK	2.74	2.42	2.56	1.75	1.20
Balochistan	1.13	1.33	1.29	1.22	0.82
Pakistan Including Karachi	100.0	100.0	100.0	100.0	100.0
Pakistan Excluding Karachi	72.58	74.08	76.10	70.49	65.14
Share of Karachi in Revenue collection in Sindh	90.05	88.80	87.57	92.02	94.25
Share of Sindh excluding Karachi in Revenue collection from Sindh	9.95	11.20	12.43	7.98	5.75

revenue kept for the province, Karachi would be far more than self-sufficient and would have a considerable surplus as well, some of which could even be transferred to the federal government or other provinces. There is little doubt that the existing economic base of Karachi, *ceterus paribus*, would allow Karachi ample resources to develop and would make it self-sufficient with a surplus.

However, let us look at some other factors, such as the distribution of resources under the existing arrangements of the National Finance Commission Award and what it would mean, under the existing terms of its mechanism, which will, of course, undergo change as new provinces emerge.

23.3.4 Implications for NFC Transfers

Straight Transfers

On account of straight transfers, Karachi may experience a significant decline because these transfers accrue to Sindh mainly on account of the Gas Development Surcharge and royalties. The oil and gas fields are in rural Sindh, therefore, revenue will be enjoyed by the rest of Sindh, whatever be the constitutional status of it. More recently, gas has been generated from Thar Coal Reserves, the royalty or surcharges will accrue to a new province if Karachi is given a separate provincial status constitutionally.

Divisible Pool Transfers

Pooled resources of the federation are subject to distribution amongst the lower tiers of government in accordance with the mandate given to the federal government by the Constitution. In Pakistan, for a long while the resources have been distributed on the basis of limited criteria which amounted to the accumulation and inclination of skewed resource allocation in favour of the Punjab due to its relative size according to population. So there was growing agitation amongst the rest of the provinces on the grounds of fiscal unevenness and on the political side as well, because with more than 50 per cent of the population, the vote can influence any decision in its own favour despite established aspirations of the rest of the three provinces. In the NFC Award 2010, the fiscal history of the country registered a major turnaround. The old traditional approach of the population-based formula was unanimously agreed to be changed, to be based upon multiple criteria—see also Chapter 13.

The main point which emerges on the basis of this evaluation of the 7th NFC Award is that the revenues generated from Karachi would be subject to redistribution via the mechanism of the divisible pool after redefining Karachi as a separate province. This would certainly cut down the share of Karachi and may become a source of agitation due to disparities between resource generation and resource distribution.

23.3.5 Demographic Trends

It is critical to examine the nature of the demographic and linguistic structure and trends in Karachi before one can make political demands related to the creation of a province. A number of important facts about Karachi need to be highlighted.

a) Karachi's population growth rate over the last few decades has been *falling* and may have stabilized at the moment. Table 23.14 shows that the average annual growth rate of Karachi had fallen to around 3.52 per cent in the 1998 Census, compared to the average annual growth rate in the 1981–98 period, which was much higher, at almost 5 per cent per year. *This means that Karachi might be growing at a slower rate than it has in the past*. The next Census might reveal different figures, but this is what we have at the moment.

b) Table 23.15 shows, that the migrant population residing in Karachi has fallen from almost 33 per cent in 1981 to near 22 per cent in 1998. This is not surprising, given the first wave of migrants to Karachi from India, which completely changed the demography of the city. *Now, there is slower migration into Karachi, and all or almost all is from within Pakistan*. This has a major development on the future of the demographics of Karachi—see below. Table 23.15 Panels B and C show the same trend with further bifurcation of the nature of migration into Karachi. Panel D in Table 23.15, links the migration trends into Karachi based upon languages spoken in Karachi. As more migrants have come into Karachi from the rest of Pakistan, despite a stable growth rate for the city, the proportion of non-Urdu speakers has increased.

From the above, we can see that the Urdu-speaking population's share in Karachi has fallen from a majority of 54.34 per cent to 48.52 per cent in 1998. *It is very probable that this proportion has fallen further in the 1998–2013 period*. The reason for this continued fall is that the in-migration into Karachi is now from the rest of Pakistan and not from outside of Pakistan (perhaps a marginal amount). This is especially so since the first waves of Urdu-speakers who came to dominate Karachi, has now ceased. This is not a question of a higher birth rate of different nationalities or linguistic groups within Karachi, but the fact that as migration continues into Karachi, it will only be at the expense of the proportion of Urdu-speakers who are now in a minority compared to the non-Urdu speakers in Karachi. This has a major repercussion on the political question of a Karachi province.

However, what needs to be recognized is that all predictions made by academics show that Karachi's Urdu-speaking population will continue to fall as a proportion of the people of Karachi. Table 23.15 Panels E–G show projections made which confirm this trend.[23]

23.3.6 Karachi as a Province?

Given the political demand to create more provinces in Pakistan, and with Karachi having almost ten per cent of the country's population, it is important to assess the viability of such a project. The argument has been made above, that Karachi can survive and probably thrive as a provincial entity.

Table 23.14: Karachi Population Growth

Year	Population	Increase/Decrease Over Last Census/ Survey	No. of Years in Between	Per cent Increase/ Decrease	Average Annual Growth Rate
1941	435,887	135,108	10	44.90	3.70
1951	1,137,667	701,780	10	161.00	11.50
1961	2,044,044	906,377	10	79.70	6.05
1972	3,606,746	1,562,702	11	76.50	5.00
1981	5,437,984	1,831,238	9	50.80	4.96
1998	9,802,134	4,540,422	17	86.29	3.52

Table 23.15: Migrant Population in Urban Karachi [Panel A]

	1981		1998	
Male	997339	35.25	1212882	24.17
Female	701441	29.49	852397	19.73
Total	1698780	32.62	2065279	22.11
Population wrt total urban population	5208132		9339235	

Karachi: Migrants 1921–1998 [Panel B]

	1921	1961	1981	1998
Population	217,000	1,912,000	5,208,000	9,856,530
Total Migrants	101,000	1,154,000	1,700,000	2,155,500
Migrants (wrt population)	47%	60%	33%	22%

Migrants by Place of Birth (%) [Panel C]

Migrants by Place of Birth	1921	1961	1981	1998
Total	100	100	100	100
Sindh excl. Karachi	14	2	5	NA
Balochistan	14	2	1	NA
Punjab	8	12	25	NA
NWFP	4	8	17	NA
Kashmir, FATA, NA	-	2	1	NA
India	60	74	51	NA

Mother Tongue [Panel D]

	1981 (in percentages)	1998 (in percentages)
Urdu	54.34	48.52
Punjabi	13.64	13.94
Sindhi	6.29	7.22
Pushto	8.71	11.42
Balochi	4.39	4.34
Seraiki	0.35	2.11
Others	12.27	12.44

Note: 1981 figures are in per cent, households; 1998 figures are in per cent, population

Table 23.15 (contd): Linguistic Groups in Karachi 1981 [Panel E]

Urdu	Punjabi	Pashto	Sindhi	Balochi	Hindko	Others
54.3%	13.6%	8.7%	6.3%	4.4%	1.0%	11.7%

Source: *1981 Census Report of Karachi Division*. Islamabad, 1984, 10.

Distribution of Population by Reported Mother Tongue – Karachi and Former Districts in 1998 [Panel F]

	Karachi	Central	West	East	South	Malir
Urdu	49	74	40	61	26	16
Punjabi/Seraiki	16	11	15	17	21	20
Pashto	11	5	25	6	8	21
Sindhi	7	2	6	4	11	25
Balochi	4	1	5	2	10	9
Other	12	9	10	11	25	10

Source: Population Census 1998, calculated by Haris Gazdar, 'Karachi's Violence: Duality and Negotiation', unpublished mimeo, Karachi, 2011. This discussion paper was prepared for the Round Table Forum 'Sustainable Development for Sustainable Peace', organized by Strengthening Participatory Organization (SPO), held on 23 September 2011 in Karachi.

Trends and Projections of the City's Ethnic Demography—1981 to 2025 [Panel F]

Years	Urdu %	Punjabi/Seraiki %	Sindhi %	Balochi %	Pashto %	Others %	Total %
1981	54	15	6	5	9	11	100
1998	49	16	7	4	11	12	99
2011	44	17	8	4	14	13	100
2025	40	18	9	4	16	14	100

Future Projections of Urdu-Speakers' Share in Karachi [Panel G]

Years	Urdu %	Others %
1981	54	46
1998	49	50
2011	44	56
2025	40	61

Source: Haris Gazdar, 'Karachi's Violence: Duality and Negotiation', unpublished mimeo, Karachi, 2011. This discussion paper was prepared for the Round Table Forum 'Sustainable Development for Sustainable Peace', organized by Strengthening Participatory Organization (SPO), held on 23 September 2011 in Karachi.

It has a strong economic, revenue, social, and educated base to build upon. In a static analysis, keeping everything the way it is, it seems that Karachi will not require additional resources to function and can generate much of its own revenue. However, if Karachi is made a province, its political economy will change, and this may have an impact on investment, revenue generation, revenue-sharing, the National Finance Commission Awards, and so on. One cannot ignore the future arrangement and any attempt to make Karachi a separate province must take care of dynamic analysis and simulations, which this Chapter does not cover.

However, Karachi's linguistic distribution gives rise to many other problems and issues. Unlike, say, the proposed Seraiki province, or one which is centred on the Hazara or Potowar area, Karachi's population does not belong to a homonogeous ethnicity. Karachi is not an Urdu-speaking city any longer. It is a largely multi-ethnic, and a multi-linguistic city, and the Urdu-speakers, while the main ethnic group, are by no means in the dominant majority. Any attempt to make Karachi a province based on a linguistic basis, will result in the consequences of pressure and opposition by other ethnic groups in Karachi. If a Karachi province does ever materialize, it will need to accommodate all the different linguistic and cultural groups who live in the city. It might even address the issue of ethnic differences, since Karachi province will speak for the people of Karachi, regardless of their ethnic background. Karachi has benefitted by the huge contribution of numerous ethnic groups based in Pakistan who have either migrated here or supply skills or capital. One can make Karachi province beneficial for all the residents of Karachi regardless of the many languages they speak. Incidentally, the same arguments can be made for a strong and autonomous city government as well.

23.4 Income Inequalities

Many of the issues related to inequality have already been addressed in many of the previous chapters of this book. For example, issues of access to land—a key factor which determines inequality and the ability to survive—has been raised in Chapter 5, as well as in the Chapter 22 on Poverty. Issues of gender inequality have been discussed in Chapters 20, 21, and 22. This chapter in its preceding sections and in the section previous to this one, and in Chapter 20, look at issues of regional inequality, at provinces and districts, showing the diverse disparity which exists in Pakistan due to the economic model followed, or as a result of historical and climactic factors. One gets a fair assessment of the different types of disparities across a geographical and gender divide—see also Boxes 23.4 and 23.5.

However, what is missing, is a discussion about income inequality, except perhaps data which shows a broad trend of series for the Gini coefficient. Unfortunately, one of the main problems about the absence of having any substantive numbers, or even indication, about the extent and nature of income inequality in Pakistan, is that there is very little research on the subject. There are data limitations as well, as they are in most data-related analysis in Pakistan, but economists, the few who do empirical research rather than just consulting for donor organizations, have stopped working on issues of class segregation or more specifically, on income inequality. Pakistan's economic research environment has been compromised by numerous factors, and this is reflected in the nature and quality of research that is produced. Unlike much of the research of the 1970s and 1980s, where issues of class were important categories of scholarship, research has turned to far broader categories, such as 'institutions', 'devolution', and so forth. Moreover, with the rise and consolidation of the middle-class thesis in Pakistan, differentiation between different social classes, becomes of less academic interest. Also, with the informalization of economic and social life, research has followed different trajectories. Hence, any intervention on issues of income inequality, is handicapped by the nature of data availability as well as the type of research carried out.

Exclusion, Deprivation, and Impoverishment[24, 25]

Economic growth can be recorded as the change in income per capita. For Pakistan, annual money income is nearly $1,400 per capita, having more than doubled over the last decade.[26] Why then does Pakistan have *rising impoverishment* as the number of children, women and men who remain hungry or at high risk of hunger—currently more than 50 million?[27]

Compared to the undernourished, an even larger proportion of population has remained malnourished over the years, a situation bleakly described by some as 'endemic, acute and chronic malnutrition.' One terrible consequence is that many more than 10 per cent of children in the poorest families continue to die before their fifth birthday. Exclusion from minimal schooling remains widespread—more than three-fourth of female youth are still *not enrolled* in matric, with the situation marginally better for male teenagers. Why are millions of children still forced into hazardous labour or unpaid care work, and hence out of schooling, because adults are denied decent livelihoods?

A reading of other developing countries (even excluding China) shows that *neither* mass impoverishment *nor* dreadful consequences in health and education are inevitable in South Asia. The explanation for persistent, widespread exclusion, impoverishment and deprivation in Pakistan should therefore be ascribed *to the inequitable economic structure of Pakistan*—of severe inequality in incomes, i.e. of the *social* (mal) distribution of physical and human capital; differentiated returns to these assets due to anti-labour economic policies; and perverse redistribution through other public policies.[28]

The latter aggravates asset inequity by transferring benefits through subsidies to those who are already better off, one example of which is subsidy on diesel, fertilizer and irrigation water in proportion to farm size. As compared to marginal and small farms, the largest farms devote a larger share of crop area to water-intensive cash crops such as cotton and sugarcane and therefore, receive an even larger share of undeserved subsidies. Regressive subsidies in urban areas are illustrated by subsidies to electricity and gas users, to

a minority of vehicle owners through underpasses and overpasses rather than the majority of pedestrians and users of buses. How else should we regard public spending of hundreds of billions on airports but measly allocations for train travel?

Impoverishment Threshold

The frequent approach to *absolute* poverty is to count the number of persons in those households whose income cannot purchase a standard level of *consumption*, or whose actual expenditure falls below the standard. Typically, this standard is derived from an assumption of required nutrition, usually just calories (rather than also protein, vitamins and minerals) from food.[29] This is a conservative procedure, not least because the absence of impoverishment implies higher real wages, causing prices to likely rise from the level when poverty prevails and hence, a higher nominal poverty line is required.

Studies show that impoverishment has not decreased over the last decade, and probably expanded significantly across the last decade. Rather than get stuck in estimation technicalities—an example of misplaced concreteness, as shown in Chapter 22—trends can be gauged by a simple and transparent approach that emphasizes inequality.

Mean expenditure per capita is a suitable benchmark when the associated consumption level can be considered desirable (or nearly so) to avoid impoverishment.[30] Some economic growth but much inflation (which is likely to have benefited the non-poor) resulted in average monthly expenditure increasing across the decade by four-fold to nearly Rs. 3,500 *per capita*.[31] *Extreme* poverty (including the destitute whose life depends largely on charity) may be gauged by insisting on a 'reasonable' fraction of average expenditure. For example, 75 per cent of average consumption may be associated with a minimum nutrition level lower than average intake and/or minimal share of food in consumption expenditure to be higher than average share. Such a conservative threshold in prevailing prices would now be monthly per capita expenditure of nearly Rs. 2,500 to include both food and non-food expenditure.[32]

Inequity due to Inequality

Assets and returns are entrenched in inequality in South Asia. Hence, earnings, income and consequently consumption expenditure, are distributed quite unequally across households. There should be no surprise that mass impoverishment is the result.

When ranked by consumption expenditure (standardized for household composition and size), the 'top' one-fifth of Pakistani families report a disproportionately larger share in (income and hence) expenditure. Hence, a disproportionately smaller share in expenditure accrues to the bottom two-fifth households. Such disparity—generated and perpetuated by the state—results in mass impoverishment i.e. *inequity*, when average national income significantly exceeds the impoverishment threshold, or at least makes indefensible the existence of extreme poverty.

Using expenditure below Rs. 2,500 per capita as an indicator of extreme impoverishment as well as high risk for becoming extremely impoverished, household surveys suggest that a population of 70 million is afflicted.[33] Extreme poverty could well have *doubled* over the decade, using a threshold of Rs. 500 per capita based upon average expenditure in 2001/2.

These are conservative estimates.[34] Additional vulnerability of sliding into extreme poverty exists for several more million citizens, because their ability to consume is seriously threatened due to illness or a loss of job, resulting in, for example a less nutritious diet or removal of a girl from school to avoid hunger. It is no wonder that the malnourished continue to exceed the undernourished by a huge margin, with patriarchy burdening girls and women more than boys and men—see also Chapter 20.

Asset Inequality

Incomes remain highly differentiated because of the very unequal distribution of assets and their returns. Whether in rural or urban jobs, very large numbers of workers lack the levels of education necessary for high-pay employment—nearly half of the labour force is illiterate, and at best one-fourth of employed adults have 10 and more years of schooling. Additional years of formal education do expand salaries disproportionally, but at unaffordable costs for high quality skills. Informal apprenticeship for skills is lengthy, comes at the cost of foregoing formal schooling and of enduring hazardous working conditions as child labour.[35] Subsequently, financial capital for high-income self employment is also difficult and expensive to access for most of the impoverished without family property.

Rural impoverishment is largely a result of very unequal access to natural resources—ownership of agricultural land, rights to public water and claims to other public assets like forest. Consider agricultural land, which also define claims to water (rain, groundwater and canal irrigation).[36]

In consequence, among the 8 million plus landowners, two-thirds have less than one-fifth of land whereas less than 2 per cent of the largest landowners claim one-fifth of land (excluding large-scale, illegal land grabs such as in the flood plains and forests).

Inequality of farmed land could be less acute than of owned land because the landless and small owners can take land on rent from the very large landowners. However, the disparity remains virtually the same as in owned land—the bottom two-thirds of farms have barely over one-fifth of farmed acreage.

The disparity in agricultural income alone can be worse for several reasons, including the fact that the majority of rented land is through sharecropping and tenants are lucky to get half of net income. Other reasons include preferential access to water and credit for farm inputs, and sale opportunities, remaining biased towards the larger landowners and larger farmers.

Inequality in Earnings and Wages

We referred earlier to income (or consumption) inequality between households (and persons). Additional insights

for public action may be obtained by disaggregating such inequality into its structural components. We can also ask why the state fails to ensure minimum earnings that would eradicate impoverishment, or at least banish extreme poverty.

Macroeconomic and monetary policies (including public debt) influence not simply the degree of economic growth but also the distribution of the additional (as well as pre-growth) income between households—rural gaining less than urban households; women less than men; unskilled less than skilled, and so on.[37] If the impoverished are very lucky, their numbers can decrease. When not excluded from growth, many may be lucky to have the intensity of their suffering decrease even as very few escape poverty altogether. What has been happening in Pakistan?

Consider first, inequality in earnings across broad sectors—agriculture, industry and services—without distinction between modes of work (employee, employer or self-employed, unpaid family worker). The country has considerable disparity, illustrated by comparing average earnings (per earner) in rural agriculture: only one-third of that earned in urban manufacturing, and around one-fourth earned from services in urban wholesale and retail trade.

So that being poor or not depends on the sector of available work. Earning differentials correspond only partially, and perhaps poorly to labour productivity for various reasons, including the degree of monopsony in a sector which creates a wedge between productivity and earnings, as well as the cost of relocating to occupations with higher earnings.[38] It would be somewhat comforting to know that earnings reflect risk premiums but agriculture is likely to have more risk, such as weather, and larger risk, such as the entire crop.

The link between impoverishment and inequality becomes even more pronounced when one observes disparity among workers *within* sectors. As a consequence of inequality in farm land, workers in the bottom quintile in rural areas received a share in agriculture earnings of less than one-half of that obtained by the top quintile. Stark inequality is reported in urban Pakistan (in part because top rural earners avoid or evade complete information). In manufacturing, and in trade services, the bottom quintile got less than three per cent of earnings in contrast to more than one-half going to the top quintile.

In recent years the government (prodded by its donors) has encouraged self employment in nonfarm 'enterprise' as a 'quick-fix' for escaping impoverishment. What is the evidence for successful poverty eradication? One finds average household income from non-farm self-employment to be less than one-half of average wage (and salary). That contrast makes one doubtful of poverty eradication except of course for those denied decent employment. Examining disparity within wage workers and within the self-employed, reinforces the scepticism about own-account employment (which includes unpaid family workers)—the worst-off households had an average wage of more than thrice the average income from non-farm enterprise. However, it is true that the distribution of wages is more unequal than that of non-farm enterprises, but which may be more a reflection of evasion and avoidance in sampling and in declaration by high profit earners.

Contrasts between citizens by location or by gender are essential to evaluating progress in rights-based development. How then should we interpret the fact that average earnings of females remain significantly lower than for males? Is it discrimination at work? Or more importantly of limiting female freedom *to work* in occupations that favour high incomes to males? Are the differences between rural and urban incomes primarily an issue of differentials in skills and productivity? And how far is public policy responsible for such disparities in not doing what it should, but doing what it should not?

Employment and Impoverishment

Being over one-third of the employed, wage workers account for a large fraction of livelihoods. Employees and their wages are therefore, important in understanding the extent of democratic participation in the economy.

Consider then a summary indicator, as the wage-share in national income. The simplification ignores insecurity of income among wage earners that 'informalization' or 'precariousness' of employment has made similar to that in self-employment, such as trying to ensure shelter for the family can mean sacrificing food intake directly or indirectly by accepting inadequate wages. One example of the latter is brick kiln labour where 'two for the price of one' worker is common by devaluing the contribution of adult females and children in setting piece-rate compensation.[39] Agriculture labour generally gets a compensation that disregards the national minimum wage per worker (raised belatedly and inadequately by the PML-N government from Rs. 8,000 to Rs. 10,000 in 2013).

Combining average wage and the number of employees with GDP brings forth estimates of the share of wages and salaries in the economy. At less than 15 per cent of nominal GDP, the money wage share in 2010/11 of nearly 20 million workers was less than one-half their share in total employment.[40] Compared with the beginning of the decade, the wage share appears stagnant—belying claims of equitable growth.[41]

Examining the components of the wage share provides further insights into *inequality-led impoverishment*. Mean monthly wage (biased by top salary earners) was less than Rs. 10,000; the median (and modal) wage was around Rs. 7,500 (so that half of workers earned less than that). A typical family with a single wage earner would be impoverished with reference to a living wage of say Rs. 15,000.[42] To escape poverty, a desperate family would have to resort to a second adult earner at lower wages, or worse as supplier of child labour at an even more exploitatively low wage.

The other two components can be combined to interpret the wage share as the ratio of average wage to average labour productivity. The very low level of the wage share is, therefore, an indicator of the inequality of compensation between labour and capital. This worsens, if one uses national income instead of GDP, indicating the negative impact upon workers of servicing of public debt and repatriation of profits from DFI.

Comparing average wage, employment, and GDP enhance perspectives on equitable growth, i.e. poverty eradicating growth. One finds very high levels of under-employment and unpaid family workers along with unemployment. Even larger numbers remain out of the labour force, reflecting work constraints upon women but also 'discouraged workers' who have lost hope of finding decent work. Those who do get jobs are not paid sufficiently to overcome the employment deficit—and hence mass impoverishment. The ratio of average wage to GDP per employed indicates the massive injustice faced by workers in claims to social output—production from social resources regardless of 'property rights.'

Trends in various indicators can help us to understand the failure of neo-liberal economic policy in achieving the promise made of equitable growth, i.e. poverty eradication through a combination of high growth and redistribution of output. By the end of the decade, nominal GDP had become four-fold of the initial level. Employment expansion was a fraction, and the large increase in average money wage failed to compensate for this sluggishness. Of course, the differentials become smaller when using deflated GDP and real wage, but the contrast remains significant for an unavoidable conclusion: *growth failed to create corresponding responses for jobs and wages in a country beset by mass impoverishment.*[43]

Matters are bad enough when using average wage and salary to represent the economic condition of workers. The situation becomes dismal when there is *persistent and pervasive* inequality among wage and salary earners. At end decade, almost one-third were given a wage that was less than one-half of average wage (with reasons including job offers restricted to part-time employment). Such inequality has worsened over the decade.

Disaggregation by sectors provides additional insights, for several reasons. Uneven sectoral growth led to uneven expansion of employment between the unskilled and skilled and hence between rural and urban; similarly between female and male employment and incomes.[44] This matters because average earnings differ between sectors. Furthermore; inequality of earnings within a sector varies across sectors. One can look at all types of employment (through HIES) or continue analysis of wage workers (through LFS). The latter remains our focus in illustrating the issues.

First, a look at average wage differentials. Major providers of employment are Manufacturing (offering nearly one-fourth of jobs), followed by Construction, and then various Services, with Agriculture accounting for over 10 per cent of wage earners. Inequality between average monthly wages ranges from around Rs. 3,500 for rural female workers in Agriculture to almost 10 times higher average salary for urban male workers in Financial Services.[45] Across all sectors, a wage earner in rural Punjab took home Rs. 2,700, almost one-half of average wage earnings in urban Sindh during 2001/2. By the end of the decade such differentials had decreased (Rs. 7,700 vs Rs. 12,700) but absolute disparity increased, thereby failing to reduce impoverishment as rapidly as demanded by abridged rights of citizens.

In view of such wage differentials, policymakers may feel stuck with a trade-off in promoting sectoral economic and employment growth. A low-wage sector like Agriculture is more favourable to employment (in part because of low investment requirement), so that some progress can be made for the many. On the other hand, a high-wage sector like Services can allow much for some, and hence is more noticeable in successful poverty eradication. This is, in truth, a self-serving dilemma preached by the priests of neo-liberalism who embrace the status quo of *structural* inequality in a predatory state (such as the inequality in land). Islamabad, and its donors in Washington and Manila have yet to provide convincing evidence that an egalitarian economy based upon domestic demand is inferior to their obsession with export-led growth (of goods, services and labour).

Jobless Growth

'Jobless growth' has disturbed commentators in many a country, including India, as the policy failure to expand employment at a rate that would result in reducing poverty, or at least as rapidly as economic growth.[46]

One can begin by a macro overview of the last decade in Pakistan.

Employment happened to expand significantly slower than GDP growth. Why should we be worried that this could have failed to prevent reduction in impoverishment? Consider the labour force as the minimum number seeking employment to live with dignity. If the number of unemployed increases then it is likely that the poorest suffer because they are made to depend more upon expanded employment to offset low earnings.

At the beginning of the decade, those *officially unemployed* were over 3 million. This number declined slightly by the end of the decade. This decline is contentious and may be irrelevant to the impoverished population—when new jobs require skills from which the poor have been excluded; new jobs are disguised unemployment as unpaid family labour; or new jobs for the poor provide distressingly low compensation, e.g. new female employment.[47]

The Labour Force Surveys tell us that the decade began with the proportion of unpaid family labour at a substantial share of all employment, which then rose significantly by end decade. In total employment, around one-half were either under-employed (less than 35 hours in a week) or over-worked (more than 48 hours). The self-employed also increased their contribution to employment, but more than half would be considered as under-employed or over-worked. Employees also show a significant number as over-worked. Taking all employment categories together, under-employed and over-worked shares remained nearly stagnant across the decade. Hence, the increase in overall employment is tainted by under-employment and over-work. The fact of expansion in female employment is also tempered by under-employment, leading to gender differentials in earnings.

The fact of increasing unpaid labour and self-employment points to another adverse dimension of employment expansion—that of serious vulnerability to income shocks and therefore of the risk of sliding into poverty. Employees too are becoming more vulnerable as the informal economy expands in non-agricultural sectors. Hence employment

As the disparities between the regions widen, capital and labour flow from the backward to the relatively more developed region where returns are greater. Capital is transferred through banks which channelize the savings of people in backward areas as loans to capitalists in the developed region. Labour shifts to the more developed region looking for better employment opportunities. Not only does the outflow of capital reduce the future possibility of growth but there also develops an unfavourable age and sex composition of the population in the backward region (greater percentage of old men, children and non-working women) thus making it even less attractive for future industrial location. These have been defined by Myrdal as the 'backwash' effects of development.

It may be argued that as development proceeds its effects will permeate further into the economy. This process Myrdal defines as the 'spread effects' of expansion to other regions. However, he points out that ordinarily even in a rapidly developing country, many regions will be lagging behind, stagnating or even becoming poorer, and there will be more regions in the last two categories if market forces alone are left to decide the outcome. As an example, he cites the USA and Sweden which despite over a century of sustained development, reveal great regional disparities.

The Lewis Model

The Lewis model of a dual economy can also be used to show that interaction between modern and backward sectors of the economy will ultimately eliminate regional inequalities as the development diffuses. It may be argued that once the surplus labour of the stagnant sector has been absorbed by the developed sector, real wages in both sectors will rise. This will induce investment in labour-saving technology in both sectors and consequently increase productivity and growth.

In reality, however, the model does not work, as it is based on two critical assumptions which are invalid in underdeveloped countries. Firstly, it assumes that capitalists in the developed sector plough back most of their profit so that the process of absorbing surplus labour from the backward sector continues until the excess labour is eliminated. This assumption does not hold in underdeveloped countries because of the absence of a capitalist class which is prepared to invest its profits in industry rather than dissipate it in luxury consumption.

Secondly, the model assumes the capitalists will continue to expand production irrespective of any demand problem. In actual fact, there will be a shortage of effective demand because the section of society demanding luxury consumer goods in an underdeveloped country is small. The shortage of effective demand is especially important, since the model assumes that the bourgeoisie (from which demand for consumer goods comes in the first place) does not spend much on consumption.

The reason why the model ignores the problem of expanding output is that it assumes perfect competition where the individual producer sells all that he produces. However, in underdeveloped countries, monopolies have come into existence in the early stages of development with the result that capitalists tend to restrict production for the domestic market. Given the difficulties of exporting manufactures in the present framework, the process of industrialization tends to slow down so that surplus labour may never be entirely absorbed from the backward region. Hence even the Lewis model of dual economies cannot be used to argue that the market mechanism will eliminate regional inequalities over time.

Source: Hamid, Naved and Akmal Hussain, 'Regional Inequalities and Capitalist Development: Pakistan's Experience', in Zaidi, S. Akbar (ed.), *Regional Imbalances and the National Question in Pakistan* (Lahore: Vanguard, 1992, 2–6.

Appendix 23.2

Dealing with Inequality

1. Social Protection Floor

Social Protection Floor (SPF) has some very important advantages. (a) It is clearly rights-based, in spite of all economic references. It has a link with a broader social security agenda and with the decent work agenda. It also refers then to the fundamental rights at work. This has never been the case before with the MDGs or the PRSPs. (b) It has an income dimension, which is extremely important in the current discourse environment on poverty. The income dimension of poverty has too often been forgotten because of the focus on so called 'multidimensionality'. (c) SPF is meant to be a permanent mechanism, which is also new compared to the temporary safety nets and other springboards promoted by the World Bank.

Nevertheless, serious doubts and questions remain. First, there is a serious risk of terminological confusion. SPF looks like a rights-based social assistance programme with the potential of being extended, in the long term, to a universal social security programme. This terminological confusion can lead to many divergent interpretations and gives the SPF an aura it maybe does not deserve. Secondly, the question remains what the advantages for the ILO itself can be. The ILO already has a basic convention on social security and several recommendations. It did not need this new initiative, except for the extension to all people instead of all workers. SPF may take the place of the MDGs as from 2015, but if it is only a new start with a new promise and without concrete commitments, civil society will strengthen its resistance and search for other ways to claim its rights and its dignity.

Thirdly, the distinction between the formal and the informal sector is in fact outdated. Too many people do not enjoy their social and/or economic rights, are able to avoid taxes, have temporary or seasonal jobs. This makes it indeed necessary to introduce non-contributive social protection/assistance

mechanisms in order to arrive at real universal coverage. However, this growing 'precariat' can hardly be accepted as a given. Non-contributive protection systems can be no excuse to further weaken the contributive systems with their implicit role for social partners. Fourthly and finally, the taking into account of the income dimension is extremely positive. However it should not be used in order to make all essential social services into commodities that have to be paid for.

Public services remain extremely important for the preservation of life and social life, especially in the current situation where climate change risks can badly hurt poor people and poor communities. Private services will never be able to sufficiently protect them. If poor people get cash benefits it should not be, as EDR states, in order to give access to social services, but in order to give them the right to life and dignity. Decommodified public services are a major contribution to it.

In short, however positively the plans for a Social Protection Floor can be assessed, what the documents do not tell us should not be ignored. They do not speak of a redistribution of incomes. They do not speak of a 'transformative' agenda in the way the UN organizations do, meaning that development has to put an end to dual societies and has to lead to substantial societal change. They are an improvement of the current and failed poverty reduction policies. If and how they will be implemented will depend on the political willingness of governments and on the strength of social movements to put pressure on them. Civil society organizations should push for the second, vertical step of full coverage for all with social security. They should also reflect on a re-conceptualization of 'social protection' in light of the urgently needed economic, ecological and social changes. The SPF will either become the threshold on which a really universal social protection system can be built, or it will remain an improved poverty reduction within the framework of neo-liberal policies.

Francine Mestrum, 'Social Protection Floor: beyond poverty reduction?' solidar.org/IMG/pdf/draft_spf.pdf

II. Equity in Outcomes

In recent decades the mainstream response to evidence of growing inequalities has been to dismiss equality of outcome as "politics of envy" and focus instead on equality of opportunity. However, to create real equality of opportunity is a radical proposition. Moreover, one can only be confident that opportunities were equal when the outcome is equal too; any systemic disparity in outcomes—whether in terms of income and wealth, or more broadly in terms of distribution of resources, occupations and roles—alert us to a likely inequality in initial opportunities. This approach has not allowed for structural factors that influence individual outcomes and has sidelined powerful policy instruments that can reduce outcome inequalities, such as:

- macroeconomic policies to ensure that sufficient employment is created to absorb new entrants into the labour force;
- income and social policies, to ensure that labour is properly rewarded in a largely globalized economy where its bargaining power has been reduced through informalization and liberalization. These include policies to register and protect informal work, ensure effective compliance with minimum wage and antidiscrimination legislation, and state support for smallholder agriculture;
- widely accessible and good-quality social provisions, including education, health, food, housing and social security, to protect against sharp income drops from illness, old age, market risks, etc. and compensate for persistently low incomes and their structural causes;
- widely accessible infrastructure, domestic technology and care services to support the (re)production of labour, disproportionately undertaken by women and girls on an unpaid basis;
- wealth and income redistribution through land reform; and
- corporate taxation and progressive income taxation to finance widely accessible social provisions.

Lessons from successful democracies suggest that rights must be institutionalized in order to substantially reduce inequality. This means that citizens need to be able to organize and contest public policies and hold the powerful to account.

UNRISD, 'Inequality & the Post-2015 Development Agenda, unrisd.org/b2015_2, 2013

III. Social Policy

Macroeconomic policies are detached from their social moorings, focused not on creating jobs but on containing public debt and inflation. Social policies remain a palliative afterthought to address the worst social fallouts of economic policies. One illustration of a disconnect comes from poverty reduction and national development strategies, such as Poverty Reduction Strategy Papers (PRSPs), where employment was often treated as an automatic by-product of growth. The idea was that after the conditions for growth had been secured, social policy could use a portion of the resources generated to provide social services and assistance to vulnerable populations excluded from the benefits of growth. The distance between employment and social policy can also be seen, for example, in conditional cash transfer programmes not directly linked to job status.

Economic policies and the instruments chosen to implement them remain unconstrained by social objectives, such as protecting people's incomes, creating sufficient employment, or eradicating poverty. Instead they continue to be almost exclusively used to contain public debt and inflation, open product and factor markets, and liberalize external trade and capital flows.

The dominance of neo-liberal policies favouring market liberalization has also reshaped the social policy terrain. As the demand for labour has grown at a slower rate relative to its supply, bargaining power has also been shifting in favour of employers and the owners of firms. This has made it difficult to sustain collective action in support of social policies. With international sourcing of production, capital has an exit strategy if the costs of social policy are considered too burdensome.

Alternative approaches also reach the conclusion that decoupling social policy and employment is desirable, but arrive there through very different reasoning. In one such approach, social policy is decoupled from employment in order to reduce and eliminate the coercive forces that propel individuals into the labour market, and allow more flexible and creative ways of combining different types of work, leisure and capability development. Proponents argue for the provision of generous and universal social benefits so that individuals become free to choose whether to sell their labour or not.

In this framework, social policy and non-wage entitlements, including the basic income grant, are separated from the need to participate in the labour market. There is no percieved need for employment policies that focus on job creation, if the jobs created are not those that individuals would freely choose. In this sense, employment and social policy are decoupled.

UNRISD, 'Social Policy and Employment: Rebuilding Connections,' unrisd.org/b2015_3

IV. Employment as Economic Policy

Putting employment at the centre of economic policy requires:

- Deflationary macroeconomic policies which dampen employment generation should be avoided
- Opportunities for employment expansion should be explored to enable previously excluded social groups access to the labour market. Expanding the numbers in formal employment will contribute to tax revenues and social insurance funds.
- New forms of labour market regulation are necessary in order to redress the structural underpinnings of both labour market exclusion and situations of unfavourable inclusion where low earnings are coupled with highly unequal power dynamics.
- States need to develop locally appropriate revenue-harnessing systems to ensure the sustainable financing of social policies. High levels of employment are required to generate the necessary resources, through taxation and social security contributions, to create a viable welfare system. This was the premise on which the generous, citizenship-based social welfare system of European social democracies was based. Palliative safety net approaches offer inadequate protection in the face of economic risks
- A minimum safety net approach, such as a low level grant, delinked from employment, is likely to be too thin to represent an adequate response to economic risks in today's globalized economy. Such an approach, like some of the conditional cash transfer (CCT) programmes promoted in recent years, cannot adequately replace the income from wages, robust forms of public provision (of infrastructure and basic social services) and social benefits that have been traditionally linked to employment (pensions).
- Lessons from some of the more successful Latin American countries show that CCTs have worked well when they complement public provision of essential social services. Typically, extensive efforts were simultaneously made to expand social protection coverage and to regulate labour markets.
- Recipients of so called "non-contributory" grants, often women, who appear to get "something for nothing", are often subjected to various paternalistic conditionalities which restrict their rights and may even hinder their access to the labour market. Citizenship-based social provisions cannot replace robust employment policies.
- A generous citizenship-based set of social provisions, which could include a universal basic income grant, would go further than targeted approaches in meeting needs and being free of paternalistic conditionalities.
- Such provisions should complement, rather than replace, employment policies. Within this approach, there is a role for basic income to improve outcomes with regard to livelihoods.
- A successful social protection floor is one that has strong links with employment policies: first, by investing in human capital, the social protection floor contributes to "a settled and productive work force", and second, a successful floor can also act as a countercyclical stabilizer which stimulates aggregate demand.
- The long-run sustainability of a productive economy requires robust social provisions. Health, education and care services, affordable housing and transport infrastructure supplement the unpaid social provisioning by families and households. If these social services are delivered through a publicly-regulated system then they can also generate decent employment opportunities. Labour standards and protections should not be undermined and are vital for reducing conflicts between paid and unpaid labour • Key labour standards and protections—such as paid sick leave, working hours standards, and occupational health and safety—should not be undermined, as has often happened in the case of informal and nonstandard employment.
- Labour standards also have important implications for unpaid care work. Access to paid leave when a child or dependent becomes sick, for example, can be essential in resolving conflicts between paid employment and unpaid family responsibilities.

UNRISD, 'Social Policy and Employment: Rebuilding Connections,' unrisd.org/b2015_3

NOTES

1. This section makes extensive use of Zaidi, S. Akbar (ed.), *Regional Imbalances and the National Question in Pakistan*, (Lahore: Vanguard, 1992).
2. See Zaidi, S. Akbar, 'Sindhi vs Mohajir: Contradiction, Conflict, Compromise', in Zaidi, S. Akbar, op. cit., 1992.
3. For articles that provide a more detailed and lengthy historical analysis, see Zaidi, S. Akbar, op. cit., 1992, especially chapters 3 and 12.
4. Hafiz A. Pasha et al. 'The Changing Profile of Regional Development in Pakistan', *Pakistan Journal of Applied Economics*, vol. 9, no. 1, 1990, 16.
5. Ibid.
6. Ibid. 17.
7. Unfortunately no similar table exists for 1980.
8. Jamal, Haroon and Amir Jahan Khan, *Indices of Multiple Deprivations 2005*, Research Report 3, Social Policy Development Centre (Karachi: SPDC, 2007).
9. Abid Burki et al. *Industrial Policy, Its Spatial Aspects and Cluster Development in Pakistan: Volume 1 Analysis Report to the Industrial Policy 2010* (Lahore: Lahore University of Management Sciences, 18 October 2010).
10. Ibid. 349.
11. Hamid, Naved and Akmal Hussain, 'Regional Inequalities and Capitalist Development: Pakistan's Experience', in Zaidi, S. Akbar, op. cit., 1992.
12. Ibid. 1.
13. Ibid. 3.
14. Kardar, Shahid, 'Polarization in the Regions and Prospects for Integration', in Zaidi, S. Akbar, op. cit., 1992, 320–1.
15. Preface, in Zaidi, S. Akbar, op. cit., 1992, (i).
16. Ibid.
17. This section draws almost entirely from the work of Sohail J. Malik. See Malik, S. J., 'Poverty in Pakistan: 1984–85, 1987–88', in M. Lipton and J. van der Gaag (eds.) *Including the Poor* (Washington DC: World Bank, 1993), and the more recent Innovative Development Strategies (Pvt.), *Profiling Pakistan's Rural Economy for Microfinance* (Islamabad: Pakistan Microfinance Network, 2009).
18. All data are from the latest available Census of 1998.
19. Hussain Akmal et al. *Pakistan National Human Development Report Poverty, Growth and Governance* (Islamabad: UNDP, 2003).
20. Wasti, S. A. and M. U. Siddiqui, 'Development Rank Ordering Of Districts of Pakistan: Revisited', Unpublished Mimeo, (Karachi, 2003).
21. Jamal, Haroon, and A. J. Khan, *'Indices of Multiple Deprivations 2005'*, Research Report 72, Social Policy Development Centre (Karachi: SPDC, 2008).
22. Jamal, Haroon, *Income Poverty at District Level: An Application of Small Area Estimation Technique*. Social Policy Development Centre (Karachi: SPDC, 2007).
23. Clearly much has changed since the 1998 census and now with the census such a political issue, there is great resistance to conducting a new one.
24. The write-up for this and the sections which follow, has been contributed by A. Ercelawn, through extensive discussions with Karamat Ali and Muhammad Ali Shah, suggestions by Zeenia Shaukat, at the Pakistan Institute of Labour Education & Research (PILER) and the Pakistan Fisherfolk Forum (PFF).
25. This discussion omits the ecological causes and consequences of impoverishment, e.g. water pollution by industry; over-fishing; water logging and salinity; which require a separate paper. An illustration for marine fisheries is given in Ercelawn, A. 'Promoting Sustainable Livelihoods for Coastal Fisherfolk' (Karachi: Shirkat Gah, 2000). A more general introduction is available in UNDP *Human Development Report: Sustainability and Equity* (Karachi: Oxford University Press, 2011). Very perceptive is the collection in D'Souza, Rohan, (ed.) *Environment, Technology and Development: Critical and Subversive Essays* (Delhi: Orient-Blackswan, 2012). Also omitted is discussion of the nexus between poverty and remittances, where emigrant workers now pump well over $10 billion annually, considerably more than external loans, aid, and foreign investment combined. For an introduction see Ercelawn, A., 'Freezing or Dissolving Poverty in South Asia: The Significance of International Emigration and Remittances in Pakistan', (Karachi: PILER, 2008).
26. Adjusting for Purchasing Power Parity would more than double the current income level, making it more than seven times an international extreme poverty line of $1.25 per day per capita.
27. Numbers in poverty use official population estimates, along with poverty incidence. See: Jamal, Haroon, 'Pakistan Poverty Statistics', (Karachi: SPDC, 2012).
28. Among recent studies, two stand out for their incisive analysis and readability: United Nations Research Institute For Social Development (UNRISD), *Combating Poverty and Inequality: Structural Change, Social Policy and Politics* (Geneva; ILO, 2011), International Institute for Labour Studies, *World Of Work Report 2011: Making Markets Work for Jobs*, (Geneva: ILO Publications, 2011).
29. For multi-dimensional poverty measures now increasingly used, see Jamal, Haroon, 'An Exploratory Analysis of Inter-Temporal Multidimensional Poverty', (Karachi: SPDC, 2012). Education and poverty are explored in Ercelawn, A., 'Rights, Capabilities, and Entitlements in South Asia: Lessons from Dissonance in Pakistan,' Conference Papers, Human Development and Capability Association, Oxford, 2008.
30. Note that observed consumption includes private charity, and hence biases downwards the number of citizens who are denied by the state the right to decent work. Expenditure and consumption data is taken from the periodical surveys published as the *Household Integrated Economic Survey* by the Pakistan Bureau of Statistics in Islamabad.
31. Average food consumption happens to imply a daily calorie intake *per capita* of nearly 2,200. Is this desirable nourishment or minimal? Baselines in Jamal, Haroon, op.cit, are 1,900 and 2100 *per capita* for urban and rural areas respectively, based on *per adult* calories of 2230 and 2550. Apparently, Islamabad considers 2350 calories *per adult* as desirable for the average Pakistani. For our purposes, we use 2550 as desirable in both rural and urban Pakistan, to then approximate *per capita* desirability of 2,000. Hence average expenditure of around Rs. 3,200 will afford desirable calories. A conservative threshold of 75 per cent of the desired level is nearly Rs. 2,500 per capita in 2011–12.
32. An international cut-off for extreme poverty is daily per capita expenditure of $1.25 adjusted for country Purchasing

Power Parity. This translates now into monthly per capita expenditure of around Rs. 1,400. It could be the desire to target the 'really poor'. However, possible selfishness of multinational standard-setters should not be ignored.

33. Inferred from the *Household Integrated Economic Survey 2011–12* where the lowest two quintiles had average expenditure considerably lower and the third quintile had significantly lower expenditure than Rs. 3,000.
34. It is a conservative estimate due to deliberate survey omission of street dwellers, and because expenditure includes charity receipts. Incidence is estimated using 75 per cent of the mean monthly expenditure.
35. The periodic *Labour Force Survey* published by the Pakistan Bureau of Statistics, Islamabad shows labour force participation rates to be over 10 per cent among children of age 10–14, and over one-third among youth of age 15–19.
36. Talat Anwar et al. 'Landlessness and Rural Poverty in Pakistan', *Pakistan Development Review*, 2004 is one of the few studies of poverty disaggregated by land tenure. See also Ercelawn, A., 'Income Inequality in Rural Pakistan, *Pakistan Journal of Applied Economics*, 1984.
37. Public debt through banks i.e. to their shareholders, executives and clients is unlikely to benefit the impoverished as compared to direct payments, such as in Work for Food programmes.
38. Think of cement factories and sugar mills.
39. See Ercelawn, A., 'Unfree Labour in South Asia: Debt Bondage at Brick Kilns In Pakistan,' *Economic and Political Weekly*, May 2004.
40. Since wage workers are counted at all stages of production, the extremely low share in GDP even after doubling to include the self-employed who are really wage workers, is a terrible indictment as exploitation by capital. Wages are taken from the *Labour Force Survey* and GDP from the *Pakistan Economic Survey* published annually by the Ministry of Finance, Islamabad.
41. If employment reflects the black economy better than does GDP, then the wage is even lower and is likely to have decreased over the years along with the size of the black economy.
42. See Ercelawn, A., 'Minimum Wage: Deficits in Decent Wage' (Karachi: PILER, 2011).
43. The contrast becomes sharper when note is taken of the fact that the GDP deflator is lower than adjustment in money wage, i.e. inflation in wage-goods (such as food) sharper than average inflation.
44. The political economy of a predatory state makes this inevitable, since the power and magnitude to extract and extort by elites vary by sector, especially when incremental product is increasingly influenced by choices of external debtors and foreign investors. Consider the 'joy' at having mega dams possibly financed by China, USAID, ADB, World Bank.
45. Similar disaggregation is not published for the start of the decade.
46. See Review of Rural Affairs, *Economic and Political Weekly*, December 2013.
47. Some analysts believe that unemployment worsened because unemployed heads doubled: e.g. Haris Gazdar et al. 'Seeing the Unseen: Breaking the Logjam of Under Nutrition in Pakistan', Bulletin, *Institute of Development Studies*, Sussex, *2013*.
48. See Mestrum, Francine, 'Social Protection Floor: Beyond Poverty Reduction', *GlobalSocialJustice*, 2013.
49. See Kannan, K. P. and Jan Breman, *The Long Road to Social Security* (New Delhi: Oxford University Press, 2013).

Part 9

Political Economics

In the final section of this book, in Chapter 24, we examine the context of the South Asian region, with particular emphasis on the political economy of trade between Pakistan and India, a factor which has major implications on the region, and in particular, on Pakistan. We show that the constraints to better regional cooperation and free trade are more political than economic, and there are no substantive economic arguments for not trading with each other. Moreover, the gains which can accrue to both countries are disproportionately tilted in Pakistan's favour. All this means that non-political institutional factors may have been the reason for this impasse in better trade and economic relations between the two neighbours. The fact that this relationship may be changing, might also suggest that the nature of Pakistan's internal political economy, may also have undergone some changes in the last eight years or so.

Chapter 25 brings in the critical role and impact of the War on Terror on Pakistan's economy, and examines the subsequent costs and nature of aid given to Pakistan, particularly aid from the United States. Chapter 25 makes the argument that US aid to Pakistan after 9/11 helped support the military regime in Pakistan because of fighting the US's war in the region, and that a huge proportion of the aid between 2002 and 2009 was meant for Pakistan's military. Moreover, the US continued to side with military institutions and individuals even when there was a mass movement for the removal of the military dictator, in the form of the lawyers' movement, a theme expanded on, along with that of civil society, in Chapter 27.

The argument presented in Chapter 22 of the Second Edition—Chapter 26 in this book—was that a middle class was emerging on the *political* horizon of Pakistan, after having established itself as a formidable economic entity. We were seeing the beginnings of a middle-class 'order' in Pakistan, but much still needed to be done to ensure that this was orderly. At that time, the dozens of crises and fault lines seen in the structure of the economy and society emphasized the fact that the old order may have been lost forever. What was going to replace it was still somewhat debatable in that era of visible transition. That last chapter of the book highlighted political and economic issues in the country at that time, with one eye on future directions.

The reason why the last chapter of the Second Edition is retained as it is, is to examine the political moment and context *at that time*, based on the understanding of that particular political juncture. There has been considerable change since 2004, when that chapter was written. Some analyses have proven to be incorrect, particularly about democratization in Pakistan. It is important to keep the earlier analyses and understanding, and to reflect on and build upon a more recent evaluation of trends and developments since then. Chapter 27, does this, and presents a political economy perspective of events since 2004 until the middle of 2013. This last chapter benefits from recent scholarship on Pakistan, and re-examines the political economy of the country.

These four chapters should be read together, since they form an intrinsic link between the institutions of the state, economy and society, and show how Pakistan's political economy is in a process of change and transition.

24 The Political Economy of Neighbourly Relations

Discussing India-Pakistan relations is like walking on shifting sands: one minute you are sure of your position, ready to make proclamations to change the world, and the next, the whole landscape has changed, become unrecognizable, presenting a completely different scenario. Unlike the greater degree of certainty and stability in India-Pakistan relations in earlier decades, recent years have made all situations rather ephemeral, changing quite radically, within a matter of days. The nature of India-Pakistan relations has become extremely variable and fluctuating, often touching extremes at both ends, with great euphoria of the prospects for peace followed within weeks by war.

In February 1999, the Indian Prime Minister made an historic visit to Lahore, yet in less than three months, as the snow melted, Pakistan's army under the command of its Chief of Army Staff, General Pervez Musharraf, launched its Kargil offensive. Again, in the summer of 2001, the Agra Summit anticipated a new beginning in India-Pakistan relations yet, within six months, both countries were ready to go to war. Later, as the US invasion of Iraq neared its inevitable end, India's Foreign Minister talked about the (Indian) right to a pre-emptive strike on Pakistan; yet, within days of this threat, the Indian Prime Minister offered perhaps the greatest hand of friendship to Pakistan in recent years (in April 2003), followed by the Indian Foreign Minister talking of a possible South Asian Union, and the Indian Prime Minister suggesting that there should be a common currency in South Asia. These gestures led to Confidence Building Measures between both sides, leading up to the Twelfth SAARC (South Asian Association for Regional Cooperation) Summit in Islamabad in January 2004 with the signing of numerous agreements, including SAFTA (the South Asia Free Trade Agreement) anticipating the lowering of tariffs from 1 January 2006, moving towards a region where trade and economic exchange is facilitated—see Box 24.1 for one of scores of articles which followed this Agreement. In 2004, it was anyone's guess as to what would happen next but, based on the past, it was evident that whatever situation existed at that time, it was likely to change, perhaps even dramatically. This is exactly what happened.

Positive developments took place when the democratically elected Pakistan People's Party government led by Prime Minister Yousuf Raza Gilani furthered the peace process by announcing numerous trade-related initiatives and incentives to trade with India in its first budget in June 2008. Asif Zardari, when he became President of Pakistan in September 2008, spoke of advancing peace and trade with India, promising a new era in South Asia. However, all such initiatives came to a dramatic end, as so often in the past, following the Mumbai attacks in November 2008. Nevertheless, after a few years of near breakdown, in 2011, negotiations were renewed and further developments took place, and Pakistan decided to give India the Most Favoured Nation (MFN) status, making a break from the past and heralding completely new and different possibilities. The granting of the MFN status, and what it signifies, may have been the most positive change which took place between India and Pakistan since the September war of 1965. Yet, because we have been here so many times before, it would be foolish to assume that this is a permanent turning point and that India and Pakistan are now on the road to peace, trade and cooperation. Any incident such as the 2008 Mumbai attacks, or the attack on the Indian Parliament, or any such activity by any of Pakistan's numerous terrorist organizations, can destroy all the progress which has taken place over the last few years. All analysis and expectations about the future, must move with slow, but perhaps, optimistic, caution.

Given this relationship, which has oscillated between guns and butter, any examination of India-Pakistan trade and economic relations, or even diplomatic relations, depends critically on the *moment* when that evaluation is being made. Given, that one gesture, one remark, one phone call, can bring about a complete change, standing on shifting sands makes analysis difficult. The euphoria (in Pakistan, at least) that followed Mr Vajpayee's Srinagar gesture, is evidence of this. In the middle of April 2003, for example, while there was no talk of war and none of peace either, there was the usual posturing and positioning of threats with the display of military potential. The proposal of a possibility of trade and economic co-operation would have been laughed at had one been foolish enough to make such a suggestion. Yet, a week later, it seemed as if no one had ever thought of anything else but peace, trade and economic co-operation.

Newspaper articles and televised debates all started highlighting the prospects for peace and economic co-operation between India and Pakistan. Added to this was the growing number of visits of elected representatives, of chambers of commerce and industry, and the holiest of all cows, even cricket matches became realities once again in March and April 2004. This pattern continued even after the fall of General Musharraf's government when it was replaced by the Zardari-Gilani government of the PPP, to completely break down following the Mumbai 2008 attacks in which non-state actors from Pakistan, as well as institutions of the Pakistani state backing them, were implicated. It has taken a lot of negotiations and diplomacy to move things forward,

Box 24.1

A Breakthrough in South Asia

On Friday last week the seven foreign ministers of the South Asian region arrived at a consensus on moving to a free trade regime in South Asia that marks a huge milestone in the economic integration of the region. At their Friday meeting they arrived at a consensus on a Framework Agreement for the creation of a South Asian Free Trade Area.

According to this agreement South Asia will move towards free trade in three stages: The first is a two-year grace period ending in January 2006, during which each country will ratify the framework agreement, assess the impact of free trade upon itself and draw up a negative list of products on which it will not remove duties or, where they exist, non-tariff barriers that affect its neighbours. In the second stage, which will also last two years, all countries will bring their peak import duties down to a maximum of 20 per cent and enter into negotiations over the size of their negative lists and the acceptability of the remaining non-tariff barriers. This will be stage two of the integration.

The third stage will last five years and during this period duties will be brought down to between zero and five per cent on all imports. This is the definition of free trade that was adopted by the Asian Free Trade Area. South Asia preferred this more flexible definition to the zero tariffs definition of the European Union, and Mercosul in South America.

The foreign ministers also agreed to give special treatment to the least developed countries, a move spearheaded by Bangladesh, and agreed to in principle at earlier meetings. Bangladesh asked that the duty reductions of phase two should apply to it immediately and not only from January 2006; that no anti-dumping duties should be levied on its exports, and that it be given eight years to complete the phase three. These demands were accepted with some minor reservations on the anti-dumping duties. Sri Lanka was also given six years instead of five to complete phase three. Presumably Bhutan, Nepal and the Maldives will also receive the same treatment from Pakistan as Bangladesh. They already enjoy close-to-free access to Indian markets.

The framework agreement on SAFTA, as the proposed free trade area is called, will be only one of three initiatives that have received a decisive push. The others are a South Asia Preferential Trade Agreement (SAPTA), an intermediate step to SAFTA, and a social charter.

The breakthrough on all three was made possible by a dramatic shift of policy by Pakistan. Pakistan had resisted SAFTA adamantly ever since it was formally mooted in 1997, on the grounds that it would amount to opening up trade with India by the back door. This was against its policy of putting every other kind of relationship with India on hold till it had first resolved the Kashmir dispute. When SAPTA was proposed and formally accepted in 1997, Pakistan made only a token effort to lower tariffs, by granting preferential access to just 18 products from India. These, moreover, included items like blood sausages and ski boots. This list has been enlarged by a few items each year since then but has remained largely symbolic. At a preparatory meeting in the beginning of December, however, Pakistan offered preferential trade in 262 more items, and unlike the blood sausages, these were all selected from the Indian list of proposed items.

There can be little doubt that Pakistan's change of heart is at least partly motivated by its desire to inveigle India into talks about the future of Kashmir. Ever since the Indian Prime minister Atal Behari Vajpayee signalled his willingness to attend the SAARC summit in Islamabad, Gen. Musharraf's government has taken a succession of steps to create a conducive atmosphere for the talks that he hopes will take place on the sidelines of the SAARC conference. These include the announcement of a cease-fire on the Line of Control, and his significant statement that Pakistan could set aside the UN resolutions on Kashmir in its attempt to find common ground with India in resolving the Kashmir dispute. Its sharp about turn on SAFTA are, however, the most unambiguous indicators of its change of heart and the urgency with which it views the resumption of a dialogue with India on Kashmir.

However, Kashmir is by no means the only spur that has driven the change of heart. An equally important motive is economy. Now that Musharraf has succeeded in stabilizing Pakistan's foreign exchange balance and the economy has turned the corner and begun to grow again there is a powerful urge to make sure that these gains are not frittered away in what looks like an increasingly purposeless conflict. The Pakistani government and business elite are acutely conscious that they can bring down the cost of a large variety of imports if they source them from India instead of buying them from other countries. For instance according to one study, Pakistan would save $110 million a year if it bought its tea from India instead of Kenya and other sources. There would be similar substantial savings in the purchase of steel, steel products and cement. Cars imported from India, they never tire of pointing out, would cost half as much as cars assembled in Pakistan. The resulting saving would boost demand for other products and give a fillip to industrial growth.

All in all, the future looms a lot brighter for South Asia than it did a month ago.

Source: Prem Shankar Jha, *Khaleej Times*, Dubai, 12 January 2004.

although while trade has improved, many constraints and restrictions imposed since November 2008, have been slow to be lifted. Despite the Mumbai attacks, there has been some progress and there are indications that perhaps Pakistan and India are entering into a new relationship, one that is very different from the past. Perhaps all this suggests that the people of Pakistan and India are in some ways 'natural' allies and partners wanting to work together and collectively waiting for the opportunity to do so. Perhaps it is the situation of non-peace which is the unnatural condition. However, based on the recent past, a loud voice of caution is necessary here. We have been at this juncture of peace

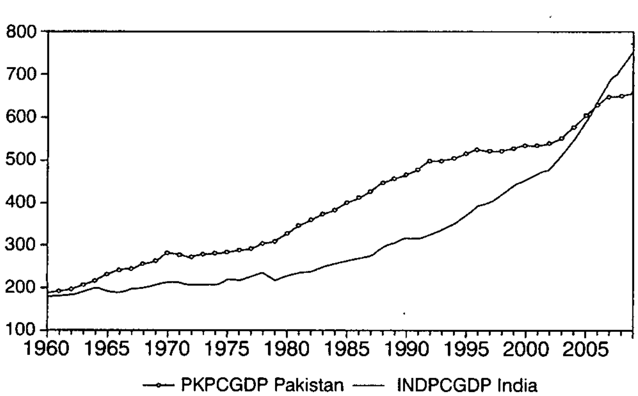
and trade between India and Pakistan, many times before, to have learnt that things can change, very suddenly and unexpectedly, wiping out all the gains that have accrued. Kargil in 1999 and Mumbai in 2008 are two such reminders, where the attempts by elected democratic governments in Pakistan to build better relations with India were sabotaged by institutions of, and backed by, the Pakistan state. Until that equation *within* Pakistan, between democratically elected governments and non-elected, authoritarian and armed undemocratic, sections and institutions is not altered, there will always be a fear of a relapse. This is also an important reason, amongst many, why Pakistan's political economy needs to be put in order for democratic institutions to dominate the political process, over nondemocratic actors and institutions.

In light of these comments, this chapter examines India-Pakistan economic (including trade) relationship primarily from the Pakistani angle. The purpose is to assess the possibility and prospects of economic and trade co-operation in light of Pakistan's development objectives and goals. Does Pakistan really need to trade with India or can Pakistan continue to manage in a non-peace, non-war, environment? Looking at ideas from International Relations theory and from Trade theory, these questions are addressed in light of (limited) empirical data. However, before we do that, let us take a brief look at comparing India and Pakistan's recent economic developments—see also Chapter 18 on macroeconomic developments since 1998.[1]

24.1 India and Pakistan: A Brief Comparison

In 1990, both Pakistan and India had identical per capita incomes, at $390 each; in 2001, Pakistan's per capita income was $420, and India's $460, and more recent data shows that India's GNP per capita in 2012 rose to $1,520, leaving

Figure 24.1
Real per Capita GDPs for India and Pakistan (2000 $s)



Source: Khan, Shahrukh Rafi, 'Growth Diagnostics: The Puzzle of Pakistan's Lagging Economic Growth', *Global Economy Journal*, (11), 2011, 7.

Pakistan behind on $1,260—see Table 24.1 and Figure 24.1. It is clear, given Pakistan's poor economic performance compared to India's these last two years, that the difference has widened further. What is more suggestive, and worrying for Pakistan, is the comparison between India and Pakistan in terms of per capita income when we use a far more useful measure called the Purchasing Power Parity (PPP) figures. These PPP comparisons allow a far better assessment of standard of living in terms of what people can actually purchase equalizing for differences in prices. Pakistan's per capita PPP income in 1990 was $1,360, while India's was $1,380. In 2001, Pakistan's per capita PPP had risen to $1,860, a rise of $500 or 37 per cent. India's PPP per capita in this decade had *more than doubled* and rose to $2,820 per capita rising to $3,876 in 2012, while Pakistan's was at $2,891. Indeed, a highly impressive achievement.

This critical indicator, that of the per capita income, is only the first of numerous social and economic indicators which show the growing difference between India and Pakistan during the 1990s, a trend which has increased further these last few years, and is going to continue to increase, for some considerable time to come into the future. Some additional figures will support this claim.

What is particularly interesting is that, in the decade 1980–90, Pakistan's economic performance measured in terms of growth rates in agriculture, industry, growth in merchandise exports, and even GDP growth, was better than that of India. In the 1990s, however, following both Pakistan and India's economic reforms and liberalization—albeit done very differently, no doubt—India's growth rates for the decade in all of these sectors (except agriculture) were not just higher, but significantly higher (often twice as high) in every single category—see Table 24.2. Perhaps the most extraordinary difference in comparative growth trends between India and Pakistan is in India's more than double export growth, and the four-times higher growth in new investment measured by Gross Capital Formation—Table 24.3. Pakistan has had very little addition to capital in the 1990s, a trend, which sadly, has been made even worse in the last two years following 9/11 and Pakistan's role in the War Against Terror—see also Chapter 18 on macroeconomic developments since 1998.

Since 1993, India's growth rate has been higher than Pakistan's *in every single year*, and in many years in the last ten, India's growth rate has been *double Pakistan's*. This is not all. If we look at all the seven SAARC countries, today even lowly Bangladesh and Nepal perform far better than Pakistan, and this is especially so if we compare them in the 1980s. In the decade of the eighties, Pakistan had the second highest GDP growth rate after the Maldives. *In the 1990s, Pakistan's GDP growth rate was the lowest of the seven.* Other data only confirm this trend. For example, during the 1990s, Pakistan's growth of value-added in industry amongst the South Asian countries was the lowest amongst the seven, and it was also the lowest for the growth of value-added in the services sector for the same period.[2]

It is not just these 'hard' economic statistics which show how Pakistan has been left behind by other SAARC countries and particularly by India, but numerous other softer indicators also re-emphasize this trend. The UN Human Development

Table 24.1
Comparison of India and Pakistan's Economy: Panel A

Variable	Units	Scale	2005		2010		2011		2012	
			India	Pakistan	India	Pakistan	India	Pakistan	India	Pakistan
Population	Persons	Millions	1,110.00	152.53	1,190.52	171.73	1,206.92	175.31	1,223.17	178.912
GDP current prices	U.S. dollars	Billions	808.668	109.595	1,597.95	176.87	1,676.14	210.566	1,779.28	233.476
GDP per capita, current prices	U.S. dollars	Units	728.53	718.517	1,342.22	1,029.93	1,388.78	1,201.11	1,454.65	1,304.98
GDP based on purchasing-power-parity (PPP) per capita GDP	Current International Dollar	Units	2,190.27	2,231.04	3,418.60	2,720.53	3,693.53	2,786.95	3,944.30	2,859.87
Total investment	Per cent of GDP		34.153	19.081	35.412	15.365	34.394	13.403	34.64	13.726
Gross National Savings	Per cent of GDP		32.881	17.681	32.144	13.134	31.578	13.611	31.41	11.817
Value of oil imports	U.S. dollars	Billions	39.928	3.55	99.572	10.463	137.341	12.317	164.126	15.198
General government revenue	Per cent of GDP		19.102	14.145	18.816	14.356	18.464	12.768	18.794	12.766
General government total expenditure	Per cent of GDP		25.785	17.178	27.981	20.258	27.125	19.124	27.109	19.478
Current account balance	Per cent of GDP		−1.272	−1.4	−3.268	−2.231	−2.816	0.208	−3.23	−1.909

Source: IMF Website www.imf.org

Panel B

	Population in million				GNI Per Capita $			GNI Per Capita at PPP $		
	1990	2001	2010	2050	1990	2001	2009	1990	2001	2009
India	850	1,032	1,225	1,614	390	460	1,220	1,380	2,820	2,993
Pakistan	105	141	174	335	390	420	1,000	1,360	1,860	2,369

Source: Chadha, Rajesh and Devendar Pratap, 'New Era of India-Pakistan Trade Relations: More Butter and Less Guns' unpublished mimeograph, New Delhi, 2003

Index (HDI) is a good indicator of broad social development in a country and includes social indicators as well as economic ones. In the HDI ranking of 1991, Pakistan was placed higher (better) than India and Bangladesh. In 2003, India is ranked far higher than Pakistan, as is Bangladesh. More importantly, Pakistan's rank fell from being at 138 to the 144th rank in just one year, 2002/3, and Nepal and Pakistan were the only two non-African countries to be classified in the low human development group. Clearly, a most ignoble achievement—see also Chapter 19 for additional comparisons.

There are numerous other social and economic indicators which re-emphasize the fact that Pakistan had been left far behind. Poverty in India, for example, has fallen from 45 per cent of the population in 1983 to 26 per cent in 2005; in Pakistan it increased from 17 per cent in 1987 to 33 per cent. Not only do the past trends show a worsening gap, but while Pakistan was celebrating 6 per cent growth in GDP for the first time since 1995, in 2003/4, the Reserve Bank of India was increasing its earlier expectations to well above 6 per cent for the next three years for India, and GDP grew by 8.1 per cent in India in 2003/4.

The difference is clear: *India's economic growth has overtaken Pakistan's*, a trend which is unlikely to be reversed for some time to come.

24.2 Theorizing Trade, War, and Peace

One of the important questions International Relations (IR) theory tries to answer is, whether economic interdependence increases or decreases the probability of war between states.

An assessment of relative gains, relative power and the relative salience of different causal variables throws some light on such questions. Liberals would 'tend to argue that economic interdependence lowers the likelihood of war by increasing the value of trading over the alternative of aggression: interdependent states would rather trade than invade. As long as high levels of interdependence can be maintained, liberals assert, we have reason for optimism'.[3] Realists who dismiss this argument, would argue that 'high interdependence increases rather than decreases the probability of war. . . . Accordingly, interdependence—meaning mutual dependence and thus vulnerability—gives states an incentive to initiate war, if only to ensure continued access to materials and goods'.[4] Developing on more dynamic aspects of these possibilities, one can also include the analysis of 'expectations from trade', and potential trade forgone, by examining the impact on the overall expected value of trade if a state decides to forgo (or wage) war.

Table 24.2
Economic Structure and Trade Dependence of India and Pakistan

	Sectorial Value added as % GDP												Trade/GDP Ratio			
	Agriculture				Industry				Services							
	1980	1990	2000	2009	1980	1990	2000	2009	1980	1990	2000	2009	1980	1990	2000	2009
India	39	31	25	17.7	24	28	27	27	37	41	48	55.3	16	17	31	43.6
Pakistan	30	26	26	21.6	25	25	23	24.2	46	49	51	54.2	37	39	35	33.2

Note: Trade is the sum of exports and imports of Goods and Services
Source: Chadha, Rajesh and Devendar Pratap, 'New Era of India-Pakistan Trade Relations: More Butter and Less Guns' unpublished mimeograph, New Delhi, 2003

Table 24.3
Growth of Sectoral GDP, Merchandise Exports, and Gross Capital Formation in India and Pakistan

Averages From – To	Average Annual Growth (%)											
	Agriculture		Industry		Services		GDP		Merchandise Exports		Gross Capital Formation	
	India	Pakistan	India	Pakistan	India	Pakistan	India	Pakistan	India	Pakistan	India	Pakistan
1980–1990	3.1	4.3	6.9	7.3	7.0	6.8	5.8	6.3	7.3	8.1	6.6	5.8
1990–2000	3.0	4.4	6.4	3.9	8.0	4.4	6.0	3.7	9.5	4.3	7.9	1.8
2001–2011	4.3	2.7	10.1	5.2	11.5	5.2	7.4	5.2	16.8	10.9[P]	31.2*	–0.1

Sources: **Pakistan**
State Bank of Pakistan, *Handbook on Pakistan's Economy 2010–11*; Government of Pakistan, *Pakistan Economic Survey 2011–12* (Islamabad: GOP, 2012); State Bank of Pakistan, *Annual Report 2010–2011* (Karachi: SBP, 2011)
Gross Capital Formation = Gross Fixed Capital Formation; Merchandise Exports = Export of Merchandises; (10 years averages).
India
Reserve Bank of India, *Handbook on Indian's Economy*, 2011

The core liberal position is that trade provides valuable benefits or gains from trade to any particular state, and trade pays more than war, especially for dependent states. Corollaries on this theme say that high trade levels would promote domestic prosperity, which would help counter domestic problems and thereby bring about internal stability; with interdependence there would be greater harmony between the people of the trading states; with increased trade, new vested interests are created which push for more trade and economic exchanges promoting peace; and, long term co-operation between states grows as political ties between trading partners grow on account of increased trade.[5] Moran argues further, that there 'is an inverse relationship between the level of trade and interstate hostilities. . . . [A]s trade levels increase, so does the quantitative effect on inhibiting hostilities among states . . .'.[6] Moran, quoting Edward Mansfield argues that by using 'considerable care and rigour' he demonstrates 'that the liberal contention that trade and peace go together has some merit'.[7]

Copeland examines the expectations from trade under such circumstances and looks at levels of interdependence and expectations of future trade, where 'interdependence can foster peace, as liberals argue, but this will only be so when states expect that trade levels will be high into the foreseeable future'.[8] However, examining realist perceptions as well, he argues that 'high interdependence can be either peace-inducing or war-inducing, depending on the expectations of future trade'.[9] Once expectations about returns from trade come into the equation, according to Copeland, decisions about war and peace are seen in a different light. A highly interdependent system of trade, it is argued, can restrict war since the former can be more 'profitable' than war.

Realists, however, believe quite the converse, that interdependence in trade and economic relations can in fact be a catalyst for war since crucial imported goods can be cut off during a crisis. Clearly, the degree of interdependence and the cost of breaking that interdependence, would help decide on whether the economic and trading relations could be broken, whether by war or even simply by a termination of economic and trading (and perhaps even diplomatic) relations. The potential costs for severed trade, as well as expectations of trade in the future, would help in reaching a decision. Potentially large costs of having to adjust if trade comes to a halt, would also play a critical role in any decision to change the trade regime. The expected value of trade and the expected 'value' of war will also be a key factor in such a decision. 'If there are few benefits from trade and few costs if trade is cut off then trade does not matter much in the state's decision to go to war. When dependence is high, peace will be promoted only when the state has positive expectations of future trade'.[10]

According to many IR theorists, while absolute gains from trade go some way in explaining the choice between war and trade, relative gains, where one party gains more than

the other and disturbs an existing balance, may also affect decisions to trade or not, especially when there is a degree of hostility between concerned states. Even where there are absolute gains for both countries, 'in general, states will fear the relative gains of nearby, powerful, offensively armed and hostile nations more than those of distant, weak, defensively armed and friendly ones';[11] the offensive-defensive balance also plays a role in this decision. With gains from trade, there is also a need to consider the 'cumulation effect', where gains in one round cumulate in future rounds producing future additional relative and absolute gains.[12] Matthews argues that 'a state must always first consider the division of gains from cooperation in order to guarantee that its partner does not profit more and thus become able to threaten it'.[13] Because of this dynamic and cumulative interaction, future losses and gains affect current decisions having a bearing on whether to trade or not.[14]

The literature on trade theory and of international integration, differs markedly from IR theory, in that it does not consider security issues or issues about war and peace, concepts which are central to IR theory. Trade theory looks largely at the economics of the issue—benefits from trade, regional integration, preferential trading agreements, etc.—and while it may bring in discussion about political economy, its focus is clearly different.

Trade theory is based on the premise that there are benefits and gains to be had from trade between nations, and efficiency and welfare gains, for producers, consumers and governments will take place if there is trade. The old theories of comparative advantage—exchanging wine for cloth—have been reinforced by newer theories which look at comparative advantage in far broader terms allowing for even greater gains and benefits from trade. Current conventional wisdom talks about 'free' trade, with lowering tariff barriers and eliminating non-tariff barriers. Monitoring and evaluation of trade policy and the setting up of trans-world global agencies, such as the World Trade Organization in this age of globalization, have underlined and reinforced the faith that 'trade is good' and that not trading or autarky is 'bad'. Any discussion on the theory of trade has this assumption written in stone. Beyond this argument for free trade, a more recent literature has emerged which looks at preferential trading arrangements or regional trading blocs of some guise or the other, and examines the theoretical and growing empirical evidence which evaluate such agreements.[15]

Preferential Trading Arrangements (PTAs) incorporate many types of economic integration. A free trade area consists of provisions to reduce or remove both tariff and nontariff barriers to trade between member nations, while retaining barriers to trade with non-members. Barriers to trade between individual PTA members and non-member nations can vary and are determined by each member's policymakers. The North American Free Trade Agreement (NAFTA) is an example of a free trade area. A customs union requires members to eliminate trade barriers with each other and takes economic integration a step further by establishing identical barriers to trade against non-members, most often in the form of a common external tariff. A common market includes all the aspects of a customs union, but takes integration further by permitting the free movement of goods and services, labour and capital among member nations. Finally, an economic union represents the most complete form of economic integration; member nation social, taxation, fiscal and monetary policies are harmonized or unified.

There are numerous motivations for Preferential Trading Arrangements (PTAs). They are said to foster political stability and economic prosperity. PTAs hasten the progress of multilateral trade negotiations, such as General Agreement on Tariffs and Trade (GATT); the achievement of timely, substantial reduction in barriers to trade, particularly agriculture, intellectual property rights, services, nontariff barriers and dispute settlement procedures; and stimulate economic growth and development. Salvatore points out, that any free trade area or customs union acting as a single unit in international trade negotiations will probably possess much more bargaining power than the total of its members acting separately. Further, reaching a compromise with a unified group of nations may sometimes be easier than dealing with each nation individually.[17]

Regional trading bloc formation can both create and divert trade. Countries excluded from a trading bloc often argue that PTAs lead to increased trade within the bloc, but less trade outside the bloc. Arguments in support of PTAs state that they may eventually lead to the merger of regional blocs, and therefore multilateral trade liberalization, more quickly than through other means, such as the GATT. While both arguments have merit, the effects of PTAs are largely empirical and depend upon several important conditions.

The short term effects of creating a PTA are measured in terms of trade creation and trade diversion. According to this theory, in the case where there is full employment of domestic resources, trade creation increases the economic well-being of member nations because it leads to greater specialization in production and trade, lower consumer prices and higher disposable incomes. PTA members may import from one another certain goods not previously imported at all due to high tariffs.

Trade creation occurs when domestic production of one member nation is replaced by lower-cost imports from another member nation. The trade creation effect causes efficiency gains for member nations, because some countries shift from a higher-cost domestic source of supply of an item to a lower-cost foreign source. Member countries eventually specialize in producing those items, for which they have a comparative advantage. A trade-creating PTA may also increase the economic well-being of non-members, since some of the increase in its economic growth will produce real increases in income that will, in turn, translate into increased imports from the rest of the world.

Trade diversion occurs when lower-cost imports from a non-member nation are prevented from entering the PTA by tariff or nontariff barriers, and are replaced by higher-cost imports from a member nation. Trade diversion reduces world economic well-being since it shifts production from more efficient producers outside the PTA to less efficient producers within the PTA. The international allocation of resources becomes less efficient, and production shifts away from the pattern suggested by comparative advantage. In reality, most

attempts to create PTAs contain both trade creation and trade diversion effects and may increase or decrease member welfare depending on the relative strength of the two opposing forces. PTAs will most likely lead to trade creation and increased economic well-being of member nations when there are high pre-PTA trade barriers; the more countries included in the PTA and the larger their size, the more likely that low-cost producers will be found among member nations. A PTA formed by competitive, rather than complementary, economies is more likely to produce opportunities for specialization in production and trade creation.

Trade creation is considered to be 'good' because a more efficient supplier is substituted for a higher-cost domestic supplier. Trade diversion may be bad because a less efficient supplier in another PTA member is substituted for a lower-cost non-member supplier. When member nations are in close proximity to one another, transportation costs become less of an obstacle to trade creation as do transaction costs. If the free trade area contains countries with the lowest cost source of goods and services consumed by members nations, trade diversion is less likely to occur.

PTA formation can be expected to have major long term benefits that are important to participating nations. In fact, it has been recently estimated that the long term gains from forming a PTA often exceed the short term gains by a factor of five or six.[18] The more important long term gains include: increased competition, economies of scale, stimulus to investment and more efficient use of economic resources.

Possibly the most important single gain from a PTA is the potential for increased competition. Businesses, especially those in monopolistic and oligopolistic markets, may become sluggish and complacent when protected by barriers to trade. With the formation of a PTA, trade barriers among members are greatly reduced or eliminated, and producers must become more efficient to effectively compete with foreign firms. Some may succeed; some may merge with other firms; others will go out of business. The higher level of competition is also likely to stimulate the development and adoption of new technology and new products. The end result will be lower costs of production and, therefore, lower consumer prices for goods and services, new products and improvements in product quality.

Another benefit of PTAs is that substantial economies of scale may become possible in the enlarged market area. If firms were previously serving only the domestic market, the expanded market with the PTA may create export opportunities. If the production process possesses economies of scale, the increase in output lowers per unit costs and the price charged to consumers. The formation of a PTA is likely to stimulate outside investment in production and marketing facilities to avoid the discriminatory barriers imposed on non-member products. In order for firms to meet the increased competition and take advantage of the enlarged market, investment is likely to increase. In most cases, investment in a PTA area is an alternative to the export of products from non-member countries.

Finally, if the PTA becomes a common market, the free movement of labour and capital is likely to stimulate more efficient use of the economic resources of the entire bloc. Overall efficiency of industries and individual firms will probably increase with increased access to lower-cost capital and additional labour. Lower consumer costs and higher real incomes should follow.

In summary then, the economics of international integration suggests that regions/countries that form regional trading blocs, gain in efficiency and welfare terms, and there are allocation gains; there is increased specialization and increased production, economies of scale are introduced which expand the market size resulting in further gains due to longer production runs and therefore lower costs, and there is increased competition which has positive efficiency and welfare consequences; even trade between similar and therefore competitive, as opposed to complementary, products between countries increases as intra-industry trade takes place implying the growth of specialization within industries; larger markets are also said to attract increased foreign direct investment. A result of all this is supposed to be reflected in, amongst other things, improved national income for partner countries. What does the empirical evidence show?

The fact that as of 5 May 2003 a total of 184 RTAs were in force under notification to GATT/WTO, must suggest that countries which form such blocs do so only because they see some benefit to them.[19] In addition, all the recent and emerging evidence from regional blocs of different guises—those in the initial stage and those which are most advanced, such as the European Union—show that countries tend to benefit on account of these regional bloc arrangements. A 1985 study which examined the empirical consequences of a single market in Europe found that GNP would rise by 5 or 6 per cent in terms of 1985 data.[20] The direct cost of having trade barriers was estimated at 2.7 per cent of GDP, and that welfare benefits of integration would result in a further 5 or 6 per cent of GDP. In the mid-1990s, studies showed that as account of gradual integration, per capita income in the European Union had increased and growth rates in poorer countries had been higher than those found in richer Europe. This evidence is not restricted to Europe alone, as evidence from the southern cone countries of Latin America in the form of MERCOSUR also shows gains: intra-regional exports rose three-fold to $12 billion between 1990 and 1994, the 'transition period' of the PTA. Robson argues that 'MERCUSOR's performance to the end of the transition period is generally admitted to have been outstanding'.[21] Evidence for NAFTA also shows that the annual growth rate of Mexican real GDP over 1994–2004 is estimated to be 1.4 per cent higher with NAFTA 'resulting in a real GDP level 14 per cent higher than without NAFTA by the year 2003'.[22] While some negative consequences, especially in the short run do emerge—some regions and industries do suffer—on the whole, it seems that members of regional blocs have prospered on account of increased integration—see also Box 24.2.

24.3 Trade with India[23]

Pakistan and India have been trading with each other since 1947, and in the last 66 years, trade has come to a complete

Box 24.2

Regionalism and Trade Diversion

One of the arguments against regional groupings has been that they may not necessarily bring about welfare gains, especially in the short run, owing to their trade diverting effects. Trade diversion occurs when the participating countries in a regional grouping are not low cost producers. In this sense, he grouping may be an efficiency-reducing arrangement. Owing to regional trade liberalization, the member countries acquire an advantage over the extra-regional countries in terms of lower product prices. A member country thus switches its imports from the more efficient rest of the world producers to the lesser efficient and higher cost partner member countries. This results in resource misallocation and amounts to trade diversion. Such concepts have led analysts to conclude that regional grouping in South Asia is almost certain to be trade diverting and efficiency reducing. Such a conclusion, however, might not be valid if the following four aspects are taken into account.

(a) The assumption that participating countries are not efficient producers in all the lines of production is not valid. Earlier studies have demonstrated that within the South Asian region there are several lower until value items already present and are not being imported by the South Asian countries from within the region. They are actually being imported from outside the region. By not importing from within the region by other South Asian countries results in welfare loss. Thus, the costs of non-cooperation have been substantial. In this sense, quite ironically and contrary to received economic theories the South Asian region has been thus characterized by some sort of reverse trade diversion. However, it needs to be further explored as to what extent such trends have existed owing to quality differences of products and owing to sheer lack of business information.

(b) It has also been argued in the literature that the short run static trade diversion effects are likely to be outweighed by the long run positive dynamic effects of regional integration in terms of increased competition, economies of scale and benefits of intra-industry trade. Therefore, focusing on welfare loss in the short run could be deemed as taking a partial and myopic view of economic regionalism.

(c) What is often missed out from the analytical debate on the subject is that trade diversion in some products could itself lead to trade creation in other products over a period of time. For instance, if an intermediate product X is cheaper in a member country and it is imported by a partner member country on preferential terms, it becomes cheaper. This makes the final product highly competitive in the partner country for the production of which the imported input is used. For example, the trade of capital goods and intermediate inputs within South Asia sustains the export oriented garment industry in the importing countries. Consequently, the possibilities of trade creation in the final product increases, generating the forward linkage effect. Similar effects could also be felt through the backward linkage effect in the country producing the intermediate product. Thus, through their backward and forward linkages, trade diversion could lead to trade creation in a dynamic setting. On the whole, regional integration in South Asia could be trade creating and welfare improving.

Complementarities for Regional Economic Cooperation in South Asia

The South Asian region is viewed by some analysts, both within and outside the region, as one that is characterized by abject poverty, social backwardness and absence of economic complementarities. Such regional pessimism has an overpowering impact on the policymakers, the business communities and economic analysts despite the reality being the obverse of such a notion. The region has shown economic resilience and macroeconomic stability at the time when some of the successful economies of the world were caught by a spate of crisis events. At the macro level, the region has progressed in terms of achieving export dynamism, experiencing structural changes in the composition of trade, initiating structural transformation in their economic growth profiles and effecting economic development. There is also a growing recognition of the micro level success stories of the South Asian countries. These points are being made only to suggest that in the South Asian region intensive economic integration is possible if the objective is to effectively coordinate the success stories of different countries of the region for mutual benefits. Integration can also help in strengthening the performance of countries in different pursuits of economic development that have, so far, remained weak.

It has also been argued that the economic logic does not support regional integration in South Asia. This notion is also based on several misconceptions. It is believed that there is low potential for trade among the South Asian countries owing to a lack of trade complementarities. Since production structures among the South Asian countries are similar, they produce similar goods in the tradable sector. Therefore, they are at best competitors and there is little scope for mutual trade cooperation. One can refute this view point on the basis of two arguments. First, as various studies show, a huge amount of border trade flows are taking place between the South Asian countries that remain unrecorded. Between several pairs of countries such informal/unofficial/unrecorded trade flows are considerably higher than the official trade flows. This is only indicative of the existing complementarities between different South Asian countries. If we take into account such trade flows, intra-SAARC trade as a proportion of total SAARC trade would be higher than the estimates arrived at with the help of official trade statistics. Secondly, it has also been argued that there is a rich potential for intra-South Asian trade cooperation if South Asian trade flows are in tune with trends in the global trade flows of the intra-industry variety. If production similarity were to be a constraint on mutually beneficial trade flows, predominance of North-North trade would not have occurred in the global market. Thus, production similarities provide scope for initiating intra-industry trade flows.

The above discussion suggests that there is ample scope for enhancing regional cooperation among the South Asian countries.

Source: Research and Information System for the Non-Aligned and Other Developing Countries. *South Asia Development and Cooperation Report 2001/02*, New Delhi, 2002, 154–6.

halt or been suspended, for only nine years, between 1965–74. However, despite a largely uninterrupted trade regime since 1974, the extent of trade between India and Pakistan has been limited and almost negligible as Table 24.4 shows. Chadha and Pratap using figures only for legal trade, show:

> While about 4.5 per cent of India's total exports are directed to South Asia, the figure is 3-per cent in the case of Pakistan.[24] Exports to Pakistan constitute about 8 per cent of India's total exports to South Asia. Pakistan's exports to India have a higher average share of about 40 per cent, during 1998–2000, of Pakistan's total exports to South Asia compared with an average share of about 17 per cent during 1995–1997. In the case of imports, 0.8 per cent of India's imports originate from South Asia and the figure is 0.5 per cent for Pakistan. Within India's imports from South Asia, 36 per cent originate from Pakistan. Pakistan sources 69 per cent of its total imports from South Asia from India. Clearly, India and Pakistan are two major trading partners among the South Asian countries despite all hurdles.[25]

However, there is still no India-Pakistan trade agreement, despite the grant/non-grant of MFN status to India in 2011—see below—and Pakistan has allowed a handful of commodities to be imported from India, which have, nevertheless, increased over the years. In 1996, 615 items were permissible for trade, although 90 per cent of the trade took place in only 42 items;[26] in April 2003, following the peace gesture moved by the Indian Prime Minister, the Pakistani Prime Minister increased the number of tradable items considerably.[27]

There are some curious facts about trade between India and Pakistan which need to be highlighted and Tables 24.5–24.7 do that. Firstly, open, formal (legal) trade between the two countries continues to be very small, and has varied between a low of $106 million in 1994/5 which was a mere 0.6 per cent of Pakistan's total trade that year, to a high of $321 million in 1998/9 or 1.9 per cent of Pakistan's total trade in the 1990s. Clearly the volume and scale of trade between the two countries was very small in absolute terms and as part of the total trade of both countries. However, given the political history of the two countries with many wars and consistently poor diplomatic relations affecting trade and economic co-operation, it is believed that third-country trade and smuggling increased the volume of trade from anywhere between $1–1.5 billion in the 1990s and early 2000s, still a small number, but of somewhat more significance, particularly for the smaller economy of Pakistan.

Although much was made of the rather limited volume of trade between India and Pakistan, a number of points, especially from the Pakistani angle, have been overlooked. Firstly, the quantum of official trade between the two countries of between two to three hundred million dollars at that time, need to be supplemented with illicit trade between the two countries, and the trade of goods which originate in either country but were imported through a third country. This recalculation increases the total trade between the countries by a factor of four or five. This is a significant increase, especially when one considers the fact, that already, for Pakistan at least, using the official bilateral trade figures alone, India was the main trading partner in the SAARC region. The new set of figures would further enhance that dominance. Compared to Pakistan's neighbours, Afghanistan, Iran and China, trade with India was far greater than the former two, and with the new set of figures, India came a close second to China. Clearly, despite an unfavourable trade, economic and political environment, there was already substantial trade between Pakistan and India which had even greater economic possibilities.

Perhaps the most curious fact about Pakistan's trade with India was this assumption that it was so low. Certainly official figures, as we show in Table 24.5, do enforce that perception, but even if we limit ourselves to these official figures, some rather interesting observations emerged. For

Table 24.4
India Pakistan Trade: 1999–2000, 2012 (Max and Min Range in Percentages)

	1990–2000		2001–2011	
Share of India's Total Exports To	South Asia 2.7–5.1	Pakistan 0.2–0.4	South Asia 4.3–6.5	Pakistan 0.3–1.2
Share of India's Total imports From	South Asia 0.4–0.8	Pakistan 0.2–0.6	South Asia 0.6–1.1	Pakistan 0.1–0.2
Share of Pakistan's Total Exports To	South Asia 2.6–4.9	India 0.4–2.4	South Asia 2.9–15.2	India 0.5–2.0
Share of Pakistan's Total Imports From	South Asia 0.4–1.7	India 0.2–0.6	South Asia 2.2–7.3	India 1.4–4.3

Source: 1990–2000 Rajesh Chadha and Devender Pratap. 'New Era of India–Pakistan Trade Relations: More Butter and Less Guns', unpublished mimeo, New Delhi, 2003.
2000–2011 India Data: Reserve Bank of India, *Hand Book on Indian Economy 2011.*
2000–2010 Pakistan Data: State Bank of Pakistan, *Hand Book on Pakistan Economy 2010 Karachi 2011.*
Figures of 2011 are provisional and are from State Bank of Pakistan, Annual Report 2010–11.

example, in the 1990s when imports from India ranged from $145 million in 1998/9 to $235 million in 2000/1 and to $187 million in 2001/2, *India emerged as Pakistan's 16th biggest trading partner in terms of imports.*

In the decade 1990–2000, Pakistan had a trade surplus with India in only three of those ten years, importing far more than it exported. Most of Pakistan's exports to India have been in the 'food and related' category, rather than in raw materials, manufactured goods or intermediate products. India's exports to Pakistan (Pakistan's imports) have been distributed over the categories 'agricultural and allied products', manufactured goods and chemical and chemical related products[28]—see Tables 24.6 and 24.7. Pakistan's and India's imports have both been heavily influenced by a single commodity, usually food items as the tables show, although Pakistan did import chemicals and tyre related products. Moreover, the tables also show considerable inconsistency and annual variability between the types of commodities imported by both countries, and other than food items, there is little of a consistent pattern of traded commodities. Perhaps this suggests a curious fact, that both countries, despite extremely poor political and diplomatic relations, did turn to each other in times of need.

It is also worth highlighting some observations which give India-Pakistan trade a rather ironic twist. It was in 1977/8, when Pakistan was under General Zia ul-Haq's Martial Law, that trade between the two countries got an impetus following the 1974 protocol for the restoration of commercial relations on a government to government basis, signed by the two countries after the 1971 war. Again, still under a military government in 1987, Pakistan increased the number of permitted traded goods with India nearly six-fold, from 42 to 249, a measure which led to a three-fold increase in the following three years.[29] Also, although both countries avoided improving their mutual trading status, both turned to each other at times of crises and shortfalls of eatables. In 1990, India helped Pakistan tide over an onion and potato crisis, and again Pakistan imported 50,000 tons of sugar from India on an emergency basis in 1997. Likewise, India has also depended on Pakistan for sugar, potatoes, onions and chillies, at a time of a shortage. Most interesting is the fact that the largest amount of trade between the two countries previously, was in Pakistan's fiscal year 1998/9, when it was $ 320 million. Pakistan's fiscal year runs from July to June, which means that this was the fiscal year which followed the May 1998 nuclear tests by both countries, included the Lahore Declaration of February 1999, as well as the Kargil war of May and June 1999. By any measure, this was a rather eventful year in South Asia, and yet, registered the largest volume of trade. Moreover, in 2000/1 in General Musharraf's first full year, imports from India were $235 million, *the highest ever*. This suggests two things: India and Pakistan, despite huge differences, trade with each other at times of shortfalls and crises; and, even a military ruler can improve (trade) relations with India if need be—see also Figure 24.2.

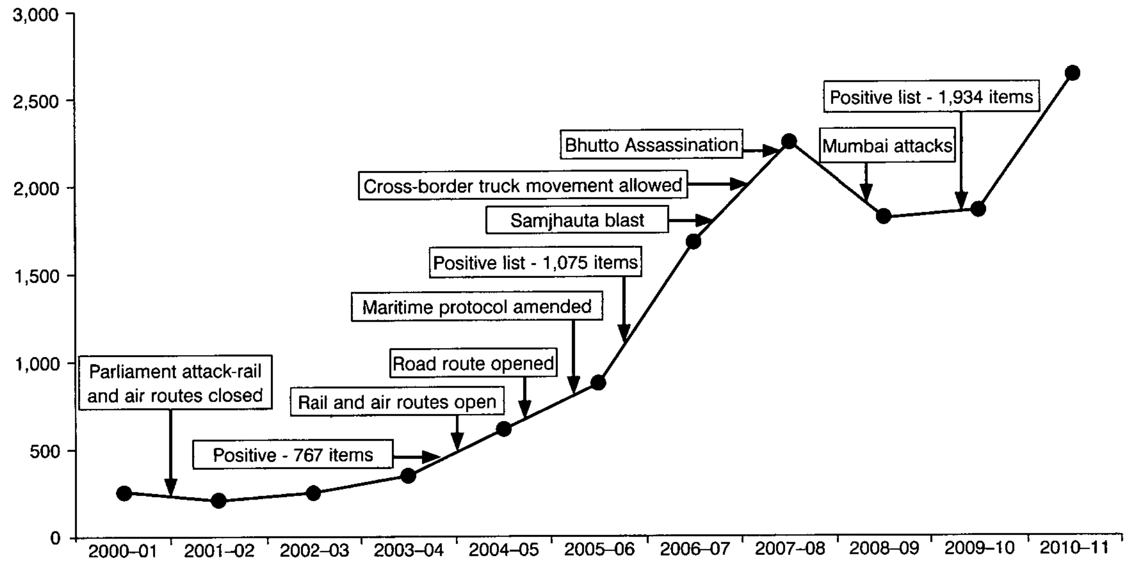
E. Sridharan argues that 'India does not import any of Pakistan's major exports. Nor does Pakistan import any of India's major exports'[30]—as we show in the tables above. He explains this fact in terms of trade-related and

Table 24.5
Pakistan's Total Trade and Trade with India: 1999–2010 ($ m)

	1992–93	1993–94	1994–95	1995–96	1996–97	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10
Total																		
Exports	6,819	6,812	8,141	8,707	8,323	8,627	7,779	8,568	9,201	9,134	11,160	12,313	14,391	16,451	17,136	19,052	17,688	19,290
Imports	8,561	8,561	10,401	11,804	11,894	10,118	9,431	10,309	10,728	10,339	12,220	15,592	20,598	28,581	30,544	39,966	34,822	34,710
India																		
Exports	83	42	42	41	36	89	175	54	55	49	71	94	289	293	344	253	311	268
Imports	67	70	64	95	197	153	146	127	235	187	167	382	547	803	1,236	1,700	1,195	1,226
Percentage share																		
Exports	1.22	0.62	0.52	0.47	0.43	1.03	2.25	0.63	0.60	0.54	0.63	0.76	2.00	1.78	2.01	1.33	1.76	1.39
Imports	0.78	0.82	0.62	0.80	1.66	1.51	1.55	1.23	2.19	1.81	1.36	2.45	2.66	2.81	4.05	4.25	3.43	3.53

State Bank of Pakistan, *Hand Book on Pakistan's Economy 2010* (Karachi: SBP, 2010).

Figure 24.2: India-Pakistan Bilateral Trade ($ Million)



Source: Taneja, Nisha, Shravani Prakash, and Pallavi Kalita, 'Issues in India-Pakistan Trade Negotiations', *Economic and Political Weekly*, vol 46, no 30, 2011.

economic (rather than political) arguments, and says that this is because of the competitive rather than complementary nature of the two economies exporting similar products, and argues, that there is the 'general tendency for poor countries to trade with developed ones rather than with their neighbours until a certain level of development has been achieved'.[31] This explains the reasons why trade did not take place between the two countries, and he thinks that 'the real scope for trade and investment is in the future and begins now'.[32] For Sridharan, however, rather than the trade of goods and commodities, 'the real potential for economic co-operation today is in energy, for example, a gas pipeline and the export of electricity . . .'.[33] Not denying the fact that past and existing patterns and trade between the two neighbours have been rather limited, we still see far greater opportunities than does Sridharan.

This point of view was also propagated by the Ministry of Commerce, Government of Pakistan, which conducted an extensive study on the prospects and implications of trade with India. The study published by the Ministry had as part of its team, a number of very prominent businessmen, all who advocated increased and fair trade with India. It is worth looking at some of the ideas which form this Report.

The Ministry of Commerce study argued that there were numerous advantages to trade between neighbours, as there are low transportation costs and cultural similarities which influence taste and cause profitable complementarities to emerge. In addition transaction costs are also lowered and such trade 'facilitates the flow of ideas and knowledge that strengthen international competitiveness'.[34] The study looked at a number of sectors in the Pakistan economy and concluded that *'the economic benefits of liberalizing trade with India outweigh costs'*.[35] Consumers in Pakistan would benefit 'unambiguously' because of lower prices, and the government will get far greater revenue from legalizing the existing illicit border trade. Moreover, 'important segments of producers would also benefit because of increased competitiveness and market access to a much larger Indian economy'.[36]

A study by the Karachi Chamber and Commerce and Industry, also endorsed the idea of trade with India, on the grounds that now having signed the agreements which have led to the setting up of the World Trade Organization, all signatory members have to be treated equally, and understood that giving Most Favoured Nation status to India 'is not a special favour to India, but an obligation under WTO and an economic and geopolitical imperative'.[37] In this new world order, the study argued, Pakistan had to face competition from all countries including India, and hence 'instead of shying away, we should be well prepared to face the eventuality. In any case, salvation lies in streamlining of operations and upgrading of technology which was long overdue'.[38] This study presented a sector-wise analysis of trade with India and the impact on each sector, looking at numerous aspects including what it called 'silver linings'. For example, it felt that while the opening up of trade with India is likely to affect the engineering sector, cheaper steel and iron ore imports from India, would have a positive impact overall and 'will result in the reduction of very high inventory costs of the engineering sector'.[39] However, the main argument which this Report seemed to be making, is *that Pakistan trades with almost every country in the world, so why not with India?*

There is also the important issue of and impact of globalization. All countries of the world are affected by it, some favourably and others not so favourably. To take further advantages or to protect themselves from the negative impacts of globalization, many neighbouring countries have established trading blocs and around 60 per cent of world

Table 24.6
Pakistan's Top Ten Imports from India (%)

Sectors	2001	2004	2007	2010
Sugar and Sugar Confectionery	37.6	0.1	5.2	27.4
Cotton	0.4	10.1	20.2	14.3
Manmade Filaments	0.0	0.0	1.1	13.4
Organic Chemicals	17.3	36.7	24.5	11.3
Residues, Waste of food industry animal fodder	4.8	8.1	5.6	3.4
Edible vegetables and certain roots and tubers	1.3	0.4	3.4	3.3
Coffee, tea, maté, and spices	0.4	0.2	0.1	0.3
Rubber and articles thereof	4.4	5.3	3.1	2.1
Oil seed, fruits, grain, seed, fruit, etc.	1.5	2.9	1.3	2.0
Miscellaneous chemical products	0.2	0.5	1.2	1.9
Others/Miscellaneous	32.1	35.7	34.4	20.5
Total imports to India	100.0	100.0	100.0	100.0

Source: Trade Map International Trade Centre, Geneva Trade Relations between Pakistan and India, January 2012 PILDAT

Table 24.7
Pakistan's Top Ten Exports to India (%)

Sectors	2001	2004	2007	2010
Edible fruits, nuts, peel of citrus fruits, melon	39.1	27.9	20.6	19.9
Mineral fuel oils distillation products, etc.	5.0	0.1	21.6	15.0
Organic chemicals	0.3	1.5	3.5	12.0
Salt, sulphur, stones, plaster lime and cement	1.7	1.3	3.1	11.4
Cotton	3.4	11.7	16.8	7.7
Lead and articles thereof	0.0	0.0	8.9	5.2
Raw hides and skins and leather	0.1	0.2	0.4	0.4
Plastic and articles thereof	0.5	0.9	0.9	3.9
Inorganic chemicals, precious metals	0.4	0.1	0.0	3.6
Wool, animal hair, yarn, and fabric	0.6	1.4	1.7	2.7
Others/Miscellaneous	49.0	55.0	22.5	18.1
Total exports to India	100.0	100.0	100.0	100.0

Source: Trade Map International Trade Centre, Geneva Trade Relations between Pakistan and India, January 2012 PILDAT

trade takes place through regional trading arrangements. There are huge advantages and benefits to such regional trading arrangements, yet, 'South Asia is the only major world region not to move towards regional co-operation and integration'.[40] Clearly, normalization of trading ties between India and Pakistan should be seen as a first step to such trading arrangements. As Burki argued, 'our policymakers must be cognizant of the fact that the world is organizing itself into a number of regional arrangements and we in Pakistan cannot afford to be left out of them'.[41]

All discussion on trade between India and Pakistan was limited by a host of factors which made conclusive analysis difficult. Firstly, no one really knew how much of unofficial (smuggled) and third-country trade actually took place, so even figures of $1–1.5 billion at that time, were open to debate; we really didn't know. Secondly, and perhaps more importantly, much of the analysis on improving trade relations between the two countries was based on a *static* analysis which was based on the very limited *existing* trade patterns. No one really knew the true potential of trade between India and Pakistan because so far most of the trade took place in a very small handful of commodities. Free, 'normal', trade between India and Pakistan would allow thousands of goods which have so far not been traded, to come into the market of both countries. For example, the talk about two pipe and gas lines from Turkmenistan and Iran to India resulting in gains to both Pakistan and India, may materialize once talks resume and political conditions improve. Although it is difficult to say how much Pakistan would gain from royalties and by laying the pipelines—royalty figures, though unreliable, were being quoted at $500 million each year for each of the pipelines—if true, they would have been equivalent to as much as 8–12 per cent of Pakistan's export earnings at that time, no mean figure to scoff at. Moreover, with lower transportation costs, there is likely to be some import 'switching' as well, where goods previously imported from other countries would now be imported from India. Trade between India and Pakistan would bring down the cost of business (particularly for Pakistan), enhance the purchasing power of consumers and increase government revenue. The volume and variety of tradable goods, given a period of time, was considered to be extraordinary.

It was argued, that if the economic and trade-related constraints were removed—for example if Pakistan granted India Most Favoured Nation status, as India had already done—there were likely to be substantive externalities which would propel trade between the two countries even further. This was despite the claim put forward by the Ministry of Commerce study that, 'given the current structure of the two economies, removal of restrictions is unlikely to increase the volume of trade dramatically'.[42] Some of the advantages of trade between neighbours have already been suggested above.

The political economy of trade between India and Pakistan, changed considerably after 9/11, and especially after around 2004/05, when General Pervez Musharraf took new initiatives to make peace with India. Pakistan's internal political

economy, and especially of Pakistan's military, had to change with the War on Terror opening another battle front on Pakistan's western border. Some readjustment in dealing with India had to be made. The result was huge increases in trade between India and Pakistan, and many of the economic arguments made prior to this period, were re-emphasized.

Tables 24.4 and 24.5 show the huge change which came after 2004 and 2005 in trade between India and Pakistan, due to changes in the political economy of the region, resulting in the need for better diplomatic and trade relations. As Table 24.4 shows, compared to the 1990–2000 period, trade between the two countries expanded many times, doubling in some years, such as between 2006 and 2007, and again, even after the Mumbai attacks, between 2010 and 2011, when India's exports to Pakistan rose from $1.5 billion to $2.3 billion. (See Figure 24.2 which shows trade between the two countries and how key political factors have had an effect on trade.)

24.4 The Benefits and Constraints of Trading with India

Some of the many benefits of trade have been discussed earlier in this chapter. In this section, we look at political economy factors which go beyond the very simple logic of trading commodities, and look at deeper structural factors and causes. Before we examine the constraints of the political economy angle of trade with India, it is best to continue with the (simpler) political economy arguments and benefits of trade.

24.4.1 The Simple Benefits of Trade

As many previous chapters have shown, Pakistan is beset with huge economic problems, especially excessive dependence on the international financial institutions, increasing debt, a poor trade (export) performance and a worsening development profile. Trade with India may not radically alter Pakistan's economy for the better (and the fears that Pakistan's economy will be swamped by cheap Indian goods are also unwarranted), but there are likely to be numerous positive externalities domestically which can accrue from opening up trade with India.

Numerous small industries are likely to benefit from cheaper raw materials from India and may help address the problem of some of Pakistan's sick industries. This is likely to have an employment-enhancing effect. Moreover, many of Pakistan's industries will benefit from increased competitiveness and will have to become more efficient in light of international and Indian imports. Also, greater market access of Pakistani exports should be beneficial. As we have argued, consumers in Pakistan are going to benefit by cheaper Indian imports as well. As the Ministry of Commerce study argued, 'exposure to competition from a neighbour would encourage policymakers as well as the private sector in Pakistan to focus more sharply on the investments needed to strengthen Pakistan's international competitiveness'[43]. Moreover, the report continued,

> the fear of a deluge of Indian products in the Pakistan market after liberalizing trade is much exaggerated. This has not happened in the past when trade has been liberalized and is unlikely to happen in the future given Pakistan's global orientation in trade and the quality conscious Pakistani consumers[44].

Also, the arguments by E. Sridharan and Government of Pakistan that 'it is unrealistic to visualize either country, particularly India, having a large impact on the total trade of the other'[45], do not examine the possibilities for presently non-trade items coming into the trade orbit.

In terms of the broader political economy factors, trade normalization is likely to improve the overall atmosphere in which India and Pakistan address all contentious issues. Even if there are no substantive improvements in confidence building measures between the two countries on account of trade, *improved trade is unlikely to make matters much worse. Trade with India, in this regard, is a win-win situation.*

Trade and economic relations would benefit Pakistan overall and particularly the Punjab and the Khyber Pakhtunkhwa Province, which have land-links with India and would allow cheap and easy access to Indian imports and raw materials. These regions are also the army's main recruiting ground and one reason why this is the case, is that alternative modes of employment other than the military services, do not exist. A possibility exists, where, with increased trade with this region, non-military employment opportunities may emerge.

With Pakistan facing a huge debt burden and with pressure to reduce expenditure, the military has also been reluctantly coming round to the need for reduction in its share of the budget, with some belt-tightening leading to a slowing down in military recruitment over the middle to long term. Besides, now that Pakistan has become a nuclear power, there may even be some arguments which suggest the need for a smaller conventional army. With Pakistan's economy in a shambles and its debt situation unsustainable, the only way to solve Punjab's employment and economic situation, is to involve the army's Punjabi constituency in trade and economic activity, and better relations with India offer that possibility.

This perhaps, is the greatest advantage of having trade with India. While trade can be a component of broader confidence building measures and an improvement in the overall atmosphere between these two neighbours, the micro level linkages and opportunities, particularly in Pakistan's Punjab and Khyber Pakhtunkhwa, may pay higher dividends. But these are rather simplistic arguments, based more on wishful thinking than the harsh realities which govern Pakistan's political economy. One should now turn to starker reality and identify the reasons why trade with India remains a problem.

24.4.2 Complicating Simplicity: The Interests of the Military

While Pakistan's businessmen and even civilian governments of both the political parties can argue about the huge benefits of peace and trade with India,[46] the biggest obstacle for either has been the Pakistani military establishment. In fact, one

can even argue that the military, when it was not in power, actually *derailed* the Lahore peace process.[47] The reasons why the military, would want to do so, also has its own logic.

The military has been the greatest beneficiary of hostile relations with India in the past. If the 'problem' over Kashmir were to ever be resolved, the military as a *political* institution, intruding in the running of government, would find that it has no *raison d'être* to intervene any more. It is Pakistan's political economy of defence, which has kept the status quo as it is. While issues of power and dominance regarding the military's presence in government are perhaps self-evident, what is often overlooked, is the economic interests which accrue to the military as a consequence of this power. If we understand the form and nature of these interests, we would be in a better position to understand why the military would be reluctant to 'solve' the Kashmir issue.

Whether the military governs directly, as it did under General Musharraf and has done for almost half of Pakistan's 66 years, or merely rules, often behind the charade of elected government, as it did since 1985, it has very strong and usually clear interests, vested and otherwise, in how the economy functions. These interests can best be analysed at three levels of disaggregation.

First, there is the individual or particularistic interest of military personnel in terms of private gains which relate to them as individuals belonging to a certain institution, in this case, the military. Next, are the interests which accrue to the military collectively, as an institution, where the benefits may be individual, or distributed collectively (though not necessarily equally), through different layers and segments of the hierarchy within the institution. And finally, the military as an institution and the individuals who make up the institution, have an interest in how the macro economy overall, functions, as this is likely to have an impact on both the institution and the individual in the military. While all three levels of interest are clearly interlinked and even overlapping, let us first begin to analyse the impact of the macro economy on the military in general.

A key factor, particularly with regard to relations with India which needs to be considered, is Pakistan's military expenditure. It has been around 5 per cent of GDP and the second largest component, after interest payments, of the budget for many years. Pakistan's military budget in terms of a share of GDP, was the 15th largest in the world—the eighth largest in terms of a percentage of central government expenditure—although this ranking does not reflect the true picture. Saudi Arabia and Kuwait are the two countries which spent the most, paying as a consequence of the (first) Gulf war; Croatia when it was at war, and Russia for historic reasons, come next, followed by Israel, Jordan and Syria. Clearly, Pakistan's ranking ought to be far higher than some of these countries which were facing short-term temporary expenses rather than clear historic trends. Besides, two on this list are oil-rich and can probably afford this extravagance; Israel is the US's closest ally and receives large amounts of bilateral and concessionary aid, as perhaps does Jordan. Pakistan, however, has a problem: it had outstanding debts equivalent to around 100 per cent of the GDP and had a growth rate over the last decade averaging barely 4.6 per cent, lower than the decade average for even Bangladesh. Undoubtedly, the state of progress of the economy is bound to have an impact on the military and its budget. One should also add that, while the human and social condition of poverty in Pakistan is such as it is, military spending in the country seems out of tune with the level of development as it exists in the country. Pakistan's defence expenditure as part of its GNP is the highest in South Asia, its defence expenditure as part of central government expenditure is also the highest in the region, *and almost twice as much was spent on defence as is on health and education combined*.

There is no denying the fact that Pakistan's economy over the decades of the 1990s, performed much more poorly compared to any previous decade, especially that of the eighties. There is one possible explanation why defence expenditure as a percentage of GDP fell from more than seven per cent of GDP in the mid-1980s to the current levels. As the performance of the economy has deteriorated, the military budget has had to be curtailed. Hence, since 1995, under democratic governments, there was no increase in real terms in the military budget. There was, however, a substantial increase of almost 11 per cent in the first budget of the Musharraf military regime 2000/1.[48]

As the considerable work by Ayesha Siddiqa-Agha has shown, the military as an institution, even when it is not overtly in power, is a major player in the economy through the very long arms of its foundations.[49] The Fauji Foundation is an economic power-house owning large assets in the industrial, services and financial sector. The other two foundations—of the navy and the air force—also make good money, are dwarfed by the size of their big brother, but nevertheless, play an important role. More recently, and most visible, is the presence of the three forces in the urban housing sector. We all know that large tracts of extremely profitable urban land are owned by the military services, but the transformation of this land into housing schemes for their personnel, further highlights the huge advantages and benefits the military has as an institution and the role that it plays in the economy. The net worth of this property is not known to civilians, and nor is the amount owned by the military in the rural/agricultural sector. Volunteered declarations of assets of top generals only reveal the tip of the iceberg.

In an issue of *Dawn*,[50] a list of 96 serving and retired military (mainly army) personnel was published with their existing positions and portfolios in the public sector: 55 on this list were serving senior military officers and 41 were retired, but holding high offices, all in the much maligned public sector. In another newspaper report, the reporter had stated that at that time (in 2000), more than 200 retired and serving military officers were employed in the public sector in prominent positions, a figure which probably understates the true extent of military involvement in public corporations and other public affairs. Another list exactly four years into the Musharraf regime showed that 1,027 civilian posts were occupied by servicemen.[51]

Since 2008, and more so in 2012 and 2013, as the democratic transition in Pakistan has strengthened, the military has been somewhat on the retreat. However, whether this is a temporary phenomenon or something which reflects

substantial structural change in Pakistan's political economy, is still uncertain—see Chapter 27.

24.5 Constraints and Possibilities: A Matter of Survival

We argue in this chapter, that for Pakistan, trade with India is beneficial in terms of economics, as well for a reorientation of its political economy. It could also be a precursor to peace with India and act as a formidable Confidence Building Measure, which could lead to a better, less hostile, environment, where other more contentious issues can also be addressed. Even if trade normalization with India does not improve things dramatically and inch us to 'resolving' the Kashmir 'problem', it is unlikely to make other matters any worse. Certainly for Pakistan, and probably also for India, *in itself*, trade is highly beneficial.[52]

Given that there are advantages to trade between India and Pakistan based on lower transportation costs, cheaper raw materials, access to each others' markets, etc. and although we do not really know the quantum and value of trade generated once 'free' trade starts, it is probable that both countries will benefit. By how much, we don't know, but all speculation suggests that trade will lead to improved welfare, cheaper commodities and greater government revenue. Countries will only trade if there are gains and benefits. Importantly, and perhaps ironically, *one of the largest beneficiaries of trade with India is likely to be Army Inc*, which gives trade with India a completely different twist. Pakistan's Fauji Foundation, which produced and traded in a vast variety of commodities, is reported to have assets worth Rs. 10 billion, making it 'Pakistan's single-largest corporate player'.[53]

There is still the unanswered question of whether both countries can develop and progress without each other. India might be able to do so, given its size and trade regime, and may not need Pakistan as an economic and trading partner. Pakistan, on the other hand, despite some economic improvement, may have to recognize India's dominance in the region and may need to trade with India in the future. Pakistan's development options in the recent and distant past, for better and for worse, have been based on the repercussions and consequences of a cocktail of the following ingredients: aid, debt, IMF/World Bank conditionality and domination, the windfall after 9/11, the first (1979) and second Afghan wars, partial debt write-off, debt rescheduling, remittances and returns and benefit on account of political and military subservience, primarily to the US—see Chapter 25. Clearly, while Pakistan has had decennial growth rates of 6 per cent plus, this heady cocktail seems to be unsustainable in the longer run.

Many liberals and well-meaning analysts and social scientists tend to argue that the reason why things are 'so bad' in South Asia where more than one-third of the population—400 million people—live in poverty, is because of the hostility between India and Pakistan. They argue that defence costs, the arms race, now turned nuclear and an atmosphere of ill-will in the region, has resulted in this underdevelopment. Is this a testable hypothesis? And, can one suggest that if this arms race were to stop and there were better relations between the two countries, would the plight of the majority of the population in the region improve? A corollary to this line of argument is that if defence costs were to fall, if South Asia declared peace, then development would take place. However, defence expenditure has fallen in Pakistan over the last decade, but interestingly, *so has development expenditure* and the human condition has actually worsened.[54]

Pakistan and India do not have a *locked-in, interdependent relationship*, of any kind, especially in terms of trade and economics. They seem to be operating separately, existing in independent orbits, largely as mutually exclusive sets. If there was a locked-in relationship, whether in terms of a far fetched idea of an effective regional trading bloc, or with pipelines across the land mass of Pakistan, or through regional collective action contra the big bad world of globalization, and if there are tangible benefits from this locked-in situation, the fear of this relationship breaking down could ensure a period of prolonged peace, as some IR theorists seem to suggest. It has been easy for both countries in the past to so easily wage or threaten war and destruction, precisely because there have been no interlocking areas of mutual interest and gain, relative or absolute. Since there are few costs to a breakdown in an unprofitable status quo, given South Asia's past, recurring crises are not surprising.

Liberals and a large section of society in Pakistan, seem to take as an article of faith that if India and Pakistan behave sensibly and put aside their numerous differences, South Asia, and particularly Pakistan, will become an economically booming place. Largely, the praetorian nature of the Pakistani state and the political economy of defence are said to be the central stumbling blocks on the Pakistan side. Theory seems to suggest, as does common sense, that there will be benefits if this were to happen—see Boxes 24.3 and 24.4 Not only will there be economic/trade related benefits, it is likely that a stop in hostilities, a curbing of the defence establishment and expenditure and a reorienting of the Pakistani military with its stake in Pakistan, may bring about far greater returns than economic/trade theory suggests.

Perhaps it is correct to surmise that any economic, political, or strategic relationship between India and Pakistan will have its rationale more in domestic politics, economics and security/strategic concerns, both in India and particularly in Pakistan (given the omnipresent military), than in any of the theories about the benefits of trade or of peace. Perhaps IR and Trade theories within the context of South Asia seem to be insufficient to explain why the situation persists as it does. And perhaps, this is why domestic politics and the domestic economy, will give direction to where South Asia is heading.

24.6 The Importance of Trade with India

As this chapter shows, and not many Pakistanis know this, India has been one of Pakistan's most important trading partners. This has been the case for many years now, despite wars, terrorist attacks like Mumbai 2008, Kargil, and a host

Box 24.3

Constraints in Intra-SAARC Trade Flows

The poor performance of intra-SAARC trade flows is due to several structural as well as policy-induced constraints. Structural constraints are manifested in low export supply capabilities, lack of investible resources due to low savings rate and technological backwardness. The policy-induced constraints include existence of trade barriers, inadequate trade facilitation mechanisms and regulated investment regimes. Added to these are lack of common perceptions about different issues, lack of awareness about the true potentials of trade cooperation and lack of adequate emphasis on some important dimensions of cooperation. All these together impede the process of cooperation and make the distribution of benefits among the member countries somewhat asymmetric. It has been observed that conflicting perceptions among different countries about a particular phenomenon often obstruct the smooth flows of tradeables. For instance, persistence of trade deficits in some SMCs vis-a-vis a large country like India is usually construed as benefitting only the larger country. Such a notion might not be entirely true, if understood from the point of view of smaller countries' gains arising out of imports from larger countries of the region. This is a case of an inadequate understanding of a given situation, as elaborated in the following section. Similar is the case with respect to rules of origin. Some view it as an obstacle to trade flows, whereas it may be argued that strict compliance to origin rules may be in fact in the developmental interests of a particular country.

It has also been noticed that the SAARC countries are quite often unaware of both the benefits of cooperation as well as the costs associated with non-cooperation. Our research suggests that costs of non-cooperation are quite significant. Therefore, increasing awareness about the benefits of cooperation among policymakers and SAARC businessmen should form a vital component of the overall strategy of SAARC regional integration.

By the same token it may be highlighted that there seems to be a lack of emphasis on areas that offer rich prospects for future cooperative endeavours. It is our contention that in order to make the SAARC regional cooperation efforts more dynamic three kinds of shifts in policy-emphasis are required. First, the emphasis should be shifted away from the intra-SAARC market to the global market and countries of the SAARC need to cooperate among themselves to meet the challengers of global competition. Second, there should be a shift of emphasis from mere trade cooperation to cooperation in areas that influence the trade flows such as investment and technological cooperation. That is to say, equal emphasis should be laid upon the phenomenon as well as the factors that make that particular phenomenon to happen. Finally, the focus should shift from exploiting trade complementarities in the realm of inter-industry trade alone to intra-industry trade as well.

When the emphasis is laid on enhancing global competitiveness of different sectors vertical integration within the region could play an important role in this process. This is possible as there does exist scope for intra-industry trade among the SMCs given the similarities in their export profiles. In doing so, determinants of intra-industry trade viz. economies of scale, product differentiation and industrial concentration would require direct policy attention. Technology and investment integration would become imperative in generating intra-industry trade within the region with the ultimate objective of boosting the global exports of SMCs. Efficient and competitive production structures in member countries need to be established, with the help of regional technological cooperation. Domestic production structures would be further required to be integrated within the region to evolve regional integrated SAARC mega-sectors and SAARC multinationals. This could be done by creating production cartels within the region and to facilitate this process of industrial restructuring a SAARC Investment Area would have to be established. Added to these, vertical integration of exporting activities could also be sought. A discussion of these issues has been undertaken in the following section in the light of the report prepared by the SAARC Expert Group (SEG) on SAARC Tripartite Study. The SEG analysed various dimensions of SAARC economic cooperation process such as transition to SAFTA, trade imbalance issue, regional investment cooperation, meeting the challenges of new technologies, enhancing global competitiveness of industrial sectors of the SAARC, industrial integration and cooperation for sub-regional development, etc.

Gains from Trade; Different Perspectives of Trade Imbalance

In recent times the issue of trade imbalance between some SMCs has emerged as a major impediment to further trade expansion within the SAARC. A close study of the trade flows among the SMCs suggests that the gains from trade are not as asymmetric among countries as is often understood. On the one hand, lower imports from smaller countries of the region into the larger countries may not be so much a problem in terms of inadequate import demand in the larger countries but they could be manifestation of low export supply capabilities of the smaller countries. Further, larger countries' exports to smaller countries' could be viewed as a catalyst to smaller countries' industrialization and overall development process. However, one should not deny the importance of tariff and non-tariff barriers and other constraints of market access in the larger economies and the need for their fast-track liberalization.

Raw materials and intermediate goods category occupies the largest share in the imports of Bangladesh and Nepal (from India) in both 1990 and 1997. In the case of Sri Lanka it had the highest share in 1990 but in 1997 the consumer goods category held the highest share. In the case of Bangladesh and Nepal the share of consumer goods was next to raw materials and intermediate goods' share in 1997.

It is clear India's exports cater to the needs of producers and exporters in Bangladesh, Nepal and Sri Lanka to quite a large extent. Thus, if the trade imbalance issue is approached in a pragmatic manner the possibilities for further expansion of intra-SAARC trade flows would be tremendous. Viewing it with a negative connotation would limit the prospects of more intensive trade integration within the SAARC region. What is required is to build production and export supply capabilities in the smaller countries if the trade imbalance is to be reduced.

Costs of Non-cooperation

The benefits of cooperation and costs of non-cooperation within the region are often not fully appreciated. In this context several questions could be posed as follows: How much do countries lose if they do not import products that are available at a cheaper rate from within the region? What are the costs of not entering into joint production, marketing and export activities? What is the extent of sacrifice that the countries make by not aiming at achieving their developmental objectives through regional cooperation in the areas of investment and technology?

It is worth emphasizing that by not cooperating on a regional basis, countries tend to lose on account of untapped expanded market, additional production and investment space and less than optimal use of natural, capital, technological and labour resources. Further, the countries would be deprived of the advantages of the economies of scale, scope and specialization if they fail to cooperate among themselves in production and trade.

However, quantitative assessment of these various dimensions of non-cooperation is often difficult and most of the questions remain unanswered due to problems of measurement of different economic variables and lack of adequate statistical database.

A simple and straightforward empirical exercise to compute the costs incurred by a SAARC member country in terms of not importing from within the SAARC region has been made here. For this purpose, unit values of items at Standard International Trade Classification (SITC) 3-digit level were computed in the case of countries for which data on quantity of exports and imports were available, viz. India, Pakistan and Sri Lanka.

These estimates are based upon both the items that are presently being imported by Sri Lanka and Pakistan from the SAARC region as well as from outside the SAARC region. They also include those items which are currently not being imported by these countries from within the SAARC region. It has been observed that many such items that are being imported solely from outside the SAARC region are interestingly being exported by other SMCs to non-SAARC countries. Since direct comparison between unit values of imports from within the SAARC region and outside was not possible, a comparison was made between the unit value of exports of SMCs (converted from FOB to CIF value by using a CIF/FOB factor) and the unit values of imports of Sri Lanka and Pakistan from outside the SAARC region.

The exercise reveals that in 1994 Sri Lanka as well as Pakistan imported many items at unit values higher than the unit values of those very items which would prevail if sourced from within the SAARC region. On this count, Sri Lanka lost approximately US$266 million in 1994 or 36 per cent of the actual import bill pertaining to these items. Similarly, in the case of Pakistan the respective figures are roughly around US$511 million and 28 per cent in 1994.

It has also been observed that in the case of Sri Lanka, unit values of imports from outside the SAARC region are on an average twice the unit values associated with regional imports of the same items, in 1994. In the case of Pakistan, the ratio between extra-SAARC unit value and SAARC unit value is approximately 1.57, in 1994.

The issue of costs of non-cooperation was analysed on a sectoral basis as well. It has been observed that in the case of Sri Lanka, the costs of not importing from within the region have been for instance, US$24 million in the case of tobacco, unmanufactured; US$17 million in the case of rotating electric plant and parts; and US$11 million in the case of fish, dried, salted, etc. Similarly, Pakistan lost US$70 million in the case of fertilizers manufactured; US$46 million in the case of organo-inorganic and heterocyclic compounds; US$40 million in the case of textile yarn and US$39 million in the case of automatic data processing machines, etc.

The above results are based on a rather simple comparison of unit values and do not take into account the possible quality differences. Hence, more detailed exercise alone can lead to exact estimates of loss arising from non-cooperation within the region. Nevertheless, they do suggest that SMCs are losing considerably by overlooking possible regional sources of supply of many of their requirements. Therefore, some policy initiative is required to create awareness among the business community of the SAARC region about the exporters of the region and their product profiles so that such information could be used while making the import decisions.

Source: Research and Information System for the Non-Aligned and Other Developing Countries, *SAARC Survey of Development Cooperation 1998/99*, New Delhi, 1999, 58–64.

Box 24.4

SAFTA Details

The South Asia Free Trade Area (SAFTA) Agreement was signed on 6 January 2004 at the 12th SAARC Summit held in Islamabad. The treaty will come into force on 1 January 2006 and will be fully implemented by 31 December 2015. SAFTA is intended to strengthen intra-SAARC economic co-operation and maximize the region's economic and social potential through various instruments of trade liberalization. The agreement binds all contracting states to reduce tariffs to 0–5 per cent by 31 December 2015.

SAPTA

Motivated by the need to move towards regional integration, the SAARC Preferential Trading Arrangement (SAPTA) came into force in December 1995. Three rounds of tariff reductions were implemented under SAPTA. Preferential treatment was offered on the basis of two categories of members, LDCs and non-LDCs. Tariff concessions received by LDCs were higher than non-LDC members. Under SAPTA, each country could decide its own line of commodities and tariff rates for preferential treatment to member countries. India offered the largest number of concessions, followed by Bangladesh, Pakistan and Nepal.

According to a report by the South Asia Centre for Policy Studies[1] SAPTA has had no significant impact on the trade patterns of South Asia. The lack of progress was attributed to limitations of the agreement and the nature of negotiations. Since concessions were made on a product-by-product basis, only a limited number of products were offered preferential tariff reductions. The report argues that most of the tariff preferences extended were not relevant to the trade interests of member countries.

Given the limited framework and influence of SAPTA, it was agreed that a more comprehensive arrangement was needed in order to ensure long-term economic co-operation. At the Male summit in 1997, member countries agreed to form a South Asian Free Trade Area (SAFTA) by 2001. The agreement was finally signed during the 12th SAARC summit on 6 January 2004 in Islamabad.

Summary/Highlights of the SAFTA Agreement

According to the agreement, the South Asian Free Trade Area is meant to "act as a stimulus to the strengthening of national and SAARC economic resilience, and the development of the national economies of the Contracting States by expanding investment and production opportunities, trade and foreign exchange earnings as well as the development of economic and technological co-operation". The objective of the agreement is to promote and enhance trade and economic co-operation by eliminating trade barriers, promoting conditions of fair competition, creating an effective mechanism for resolution of disputes, and establishing a framework for further regional economic co-operation. The following instruments are outlined for the implementation of the agreement: (1) Trade Liberalization Programme; (2) Rules of Origin; (3) Institutional Arrangements; (4) Consultations and Dispute Settlement Procedures; (5) Safeguard Measures; (6) Any other instrument that may be agreed upon.

Trade Liberalization Programme: Non-Least Developed Countries (India, Pakistan and Sri Lanka) are to reduce tariffs to 20 per cent from their existing rates within two years from the date the agreement come into force (1 January 2006). They are required to subsequently reduce their tariffs to 0–5 per cent within 5 years. Least Developed Countries (Bangladesh, Nepal, Maldives and Bhutan) are required to reduce their tariffs to 30 per cent within two years from the date the agreement comes into force, and subsequently to 0–5 per cent within 8 years. The Contracting States, however, can reduce their tariffs immediately or follow an accelerated schedule if they wish. The above tariff reductions do not apply to products included in the sensitive list, which will be developed by the Contracting States and incorporated into the Agreement. Non-Least Developed countries are also required to reduce their tariffs to 0–5 per cent for the products of Least Developed Countries within three years from the date the agreement comes into force.

Additional Measures: Contracting States agreed to include the following measures to facilitate trade and economic co-operation: (a) harmonization of standards, reciprocal recognition of tests, accreditation of testing laboratories and certification of products; (b) simplification and harmonization of customs clearance procedures; (c) harmonization of national customs classification based on HS coding system; (d) customs co-operation to resolve disputes at entry points; (e) simplification and harmonization of import licensing; (f) simplification of banking procedures; (g) transit facilities, especially landlocked contracting states; (h) removal of barriers to intra-SAARC investment; (i) macroeconomic consultations; (j) rules for fair competition and promotion of venture capital; (k) development of communication systems and transport infrastructure; (l) easing foreign exchange restrictions relating to products under the SAFTA regime and (m) simplification of business visas.

Institutional Arrangements: Contracting States agreed to establish the SAFTA Ministerial Council (SMC), which is to be the highest decision making body of SAFTA. The SMC, consisting of Ministers of Commerce of member states, will be responsible for implementing the agreement. The SMC will be supported by a Committee of Experts (COE), consisting of a senior Economic Official from each member state. The COE will be responsible for assisting the SMC in implementation of the agreement and act as a Dispute Settlement Body.

Special and Differential Treatment for the Least Developed Contracting States: The agreement binds all member states to give special consideration to Least Developed Countries regarding application of anti-dumping or countervailing measures. Least Developed Countries are allowed greater flexibility in continuation of trade restrictions on imports from member countries under critical circumstances. Non-Least Developed Countries are required to give special consideration to requests from Least Developed Countries regarding technical assistance and co-operation arrangements designed to enhance trade. Member States also agreed to establish a mechanism to compensate Least Developed Countries for loss in revenue due to tariff reductions.

Balance of Payments Measures: The agreement allows a contracting state facing balance of payments difficulties to provisionally suspend the concessions extended by the agreement.

Safeguard Measures: It was agreed that if a product is imported into a member state in such a manner or in such quantities that it causes or threatens to cause serious injury to domestic producers of competitive products, the importing country can temporarily suspend the concessions granted by the contract. The suspension, however, will be subject to an investigation by the competent authorities and can only be applied for a maximum of three years.

Dispute Settlement Mechanism: In case of a dispute, a member country can request consultations with the other member country through notification to the Committee of Experts (COE). The member country to which the request is made is required to respond within 15 days and enter into consultations within 30 days after the receipt of the request, unless otherwise mutually agreed. If the consultations fail to settle the dispute within 30 days after the receipt of request for consultations, to be extended by another 30 days by mutual agreement, the complainant can request the Committee of Experts to settle the dispute. The COE is then required to make recommendation within 60 days of the referral. Any member state which is party to the dispute can appeal the recommendation of the COE to the SMC, which is required to review the matter within 60 days.

Withdrawal: Any member state can withdraw from the agreement at any time after it comes into force.

Source: Pakistan Institute of Legislative Development and Transparency (PILDAT), *Briefing Paper for Parliamentarians*, Lahore, 23 February 2004.

[1]Kelagama, Saman, SACEPS Task Force Report on The Implications of Building a South Asia Free Trade Area: Challenges and Constraints to Regionalism in South Asia, South Asia Centre for Policy Studies.

of other diplomatic and military misadventures—see Figure 24.2.

Pakistan's largest single trading partner, since 2009 has been China, which has replaced the US, both for Pakistan's exports and for non-oil imports, although the European Union, as a bloc, is larger for both non-oil imports and exports. Almost 10 per cent of all Pakistan's imports used to come from the US, a figure which has fallen in recent years, with China by far, now becoming the major non-oil import source for Pakistan.

Pakistan continues to export approximately 18–20 per cent of its total exports to the US. Saudi Arabia, Kuwait and the UAE are Pakistan's main source of crude oil—where oil accounts for around 20 per cent of total imports; the UAE used to act as a conduit for third-country—mainly Indian—imports as well in the 1990s when direct trade between India and Pakistan was restricted. Malaysia also continues to be high on the import list, mainly for edible oil. Because of oil imports, remittances, and also as a destination for some of Pakistan's exports, the Middle East is Pakistan's most important trading region. China which has emerged as the largest source for non-oil imports for Pakistan is followed by Singapore. In terms of exports, after the US, it is Afghanistan which has became Pakistan's second biggest export market, followed by the UAE, China and then the United Kingdom.

While the trends in exports and imports mentioned above do not seem particularly striking, what is striking is that *India is today Pakistan's eleventh largest trading partner*. In terms of imports to Pakistan, *India is Pakistan's seventh largest source for imports*. This figure is even more interesting since of the largest importers into Pakistan, three are oil-exporting countries (Saudi Arabia, UAE and Kuwait) and Malaysia, which exports mainly palm oil to Pakistan. Despite hostilities, wars and diplomatic breakdowns, the difficulties with visas and restricted communication between the two countries, Pakistan imported (based only on official figures, one must emphasize which are perhaps 60 per cent of actual volume) more from India than it did in from France, Canada, Switzerland, the Netherlands, Turkey, Iran or even Thailand! Pakistan imports from India about the same value as it does from Japan. *Prior to the 2008 Mumbai attacks, India was Pakistan's fourth largest source for non-oil imports*. Indeed, a most amazing state given the political relations between the two countries.

In the last two decades, Pakistan has had a trade surplus with India in only *one* of these twenty years, importing far more than it exports. However, while many analysts point towards this imbalance of trade between India and Pakistan, the same imbalance exists with other trading partners as well. While Singapore might be Pakistan's second most important source of imports, Pakistan exports less to Singapore than it does to India. Similarly, Pakistan exports more to India than Malaysia or Kuwait, *combined*. Clearly, the India-Pakistan trade imbalance has been on account of structural weaknesses in Pakistan's exporting capabilities and the absence of exportable commodities rather than anything else.

Most of Pakistan's exports to India have been in the 'food and related' category, rather than in raw materials, manufactured goods or intermediate products. India's exports to Pakistan (Pakistan's imports) have been distributed over the categories 'agricultural and allied products', manufactured goods, and chemical and chemical related products. Pakistan's and India's imports have both been heavily influenced by single commodity, usually food items, although Pakistan increasingly imports chemicals and tyre related products.

Even under the existing curtailed and restrictive trading conditions, it is clear that India plays an important role in Pakistan's trade regime. However, if trade between both

countries were to be 'normalized' and barriers and restrictions done away with, India and Pakistan might begin to enjoy the same trade terms as China and India do, benefitting both countries. The benefits of opening up trade with India will have a favourable impact on Pakistani consumers (more choice and lower prices), manufacturers (using cheaper raw materials and inputs), and even government, since for the latter, there will be more income from trade and sales taxes especially once illegal trade becomes legalized. Although some specific industries in Pakistan will have to deal with increased competition and will suffer, there is little doubt that there will be a considerable net gain on account of opening up trade between India and Pakistan.

One other area which will benefit, is employment, especially in the Punjab and Khyber Pakhtunkhwa belt. Once trade opens up, it will bring in greater employment opportunities in the retail, services and even manufacturing sectors. Over a longer period, if trade really does become normalized and investment also increases on account of increased trade, second-round impacts will also result in a multiplier effect on the economy. There seem to be very few, if any, arguments *not* to open up trade with India. Some specific industries will require some protection in the transition period, but they will need to adapt to opening up trade and will need to diversify and modernise—see Box 24.5 for a sceptics view on trade with India, as well as Box 24.6.

Even though there had been an opening up on trade relations between India and Pakistan after the Mumbai attacks of 2008, and Pakistan finally decided to grant India the Most Favoured Nation status in 2011, even till December 2013, despite making the announcement that India 'had' or 'would be' granted the MFN status, this had not happened. Clearly, this sounds odd, and there were numerous newspaper reports which stated that Pakistan had granted India MFN status 'in principle' in 2011, but still not in practice till December 2013—see Boxes 24.7, 24.8 and 24.9. This 'double speak' only highlights the political economy nature of institutions within the Pakistani state and its establishment, who are still not comfortable making peace with India. The Nawaz Sharif government elected in May 2013 has stated on many occasions that it would ensure that India and Pakistan worked towards peace and enhanced trade and economic cooperation, yet it is clear that overcoming hostile barriers has taken longer than even the most pragmatic peace advocates had hoped.

While these simple effects of trade will have consumer-enhancing and revenue-enhancing effects, the political economy nature of better trade will also be positive. If more employment opportunities emerge, if India's consumer goods find a large market in Pakistan and Pakistani goods in India, the benefits and gains from trade will outweigh the benefits of hostilities between the two countries. With military such a dominant figure in Pakistan's economy, it too should look at increased trade as a means to making greater profits.

Trade might even lead to exchanges and alliances which today seem improbable. India and China have been adversaries for decades having fought a war, and are still involved in numerous border claims and disputes. However, China is today India's largest trading partner and has moved from almost zero trade a decade ago to $65 billion today. India and China continue to sabre rattle against each other, yet trade actively. Most importantly, since 2007, India and China, despite numerous differences, *have held three joint military exercises*! Can Pakistan look forward to some trade with India over the coming years?

Box 24.5

Trade with India: A Sceptic's Viewpoint

Yusuf H Shirazi, a major industrialist and manufacturer of cars and motorcycles in Pakistan, has historically been one of the strongest opponents of opening up trade with India. In 2012, when it became clear that India and Pakistan would start 'proper' trade with each other, he wrote:

> There are generally two views on trade with India. One view propounds more industrialisation and indigenisation through long-term policies, necessary protections and monitoring in Pakistan itself before any trade talks with India. The Engineering Development Board and the Board of Investment were set up for such purposes and have issued guidelines in order to fulfill such objectives. The Federation of Pakistan Chambers of Commerce and Industry and all other chambers except one have supported this view.
>
> The other view is free trade. This view, as propagated by developed countries, is that there is one world, one economy and one social order and hence, the economies of the developing countries should be open to the developed world's competitiveness. The World Bank and the International Monetary Fund (IMF) rely on bilateral contracts between the countries. The World Trade Organization (WTO) has multinational contracts relevant to each specific country.
>
> Following the IMF and WTO diktat, the opening of trade between India and Pakistan has been initiated. However, neither the IMF nor the WTO are relevant in this case. Pakistan has not entered into such a contract and, if at all it does, the contract will have limited applicability, keeping in view the balance of payments position and the GDP. The WTO regime, at present, is not applicable to some industries such as engineering and the automobile sector and is quite flexible in other cases also.
>
> Regardless of who says what, Pakistan may well be advised to find its own niche in the broad spectrum of the developing and developed world, which itself developed through the use of protectionist policies. They are now reinforcing this policy through expanded international alliances like the European Common Market, ECC and NAFTA—as one social order. The developed world is quite different from the developing world. Therefore, policies for developing countries must be different from those of the developed world and must vary from country

to country, according to the political, economic and social set-up of each.

Trade with India

In trade with India, one must be careful and prevent India from overshadowing Pakistan's economy, particularly in the engineering and even more so, the auto-engineering sector, where India enjoys an edge over Pakistan. If trade with India is opened without necessary checks and balances, the economy on the whole will be hit hard as well as particularly the engineering and auto engineering sector.

A rather liberal view is that, in line with the developed world's demand, there should be no localisation policy, no deletion programme and no monitoring of the industrialisation process. One may produce what one can, otherwise import. This view is in contrast with the local one that there should be a localisation policy, deletion programme and a monitoring of the industrialisation process in conformity with national interests. One must produce all that is in the national interest. The Pakistan Automotive Manufacturers Association (PAMA) particularly and the Pakistan Association of Automotive Parts and Accessories Manufacturers (PAAPAM) reinforce this view as does the Engineering Development Board.

Pakistan came into being because the socio-economic well-being of the minority Muslims in India was not being protected by the Hindu majority and Indian Muslims wanted a separate homeland. While the Muslim League accepted even Sir Stafford Cripps' offer of Muslim rule in the Muslim-majority provinces in India, the Congress rejected the proposal. After the separation, Pakistan found itself without food, clothing, shelter, etc. India was to provide food, clothing and all other such necessities till Pakistan was capable of providing for itself. But this commitment was fulfilled for a short while only and was withdrawn obviously because of backlash over the Pakistan's very existence. Otherwise why would India have discontinued these facilities, all of a sudden, against its international commitment? And why does it now want to trade with Pakistan? This question must be asked before resuming trade with India.

Indian Economy

Jawaharlal Nehru decreed that what is produced locally will not be imported. That decree is being followed in letter and spirit—through various barriers including non-tariff—so that India can export freely but not import. This measure is universal and not Pakistan-specific. Nor will India be tempted to invest in Pakistan, given its socio-political conditions and lack of physical infrastructure and human resource base. Will Pakistan invest in India in such conditions?

The Indian economy is neither supplementary nor complementary to that of Pakistan. It is highly competitive and is about ten times bigger than that of Pakistan. India is among the ten top economies of the world and ranks among the industrialised nations in the world. Manufacturing contributes high GDP. The industrial sector contributes 60 per cent of exports with engineering—auto sector—domination. The infrastructural costs are heavily subsidized and subsidies are direct income-tax exempt. It has a much bigger market; the volumes are huge and hence lower overheads. The wage structure is low as also other direct and indirect costs. The industry is thus highly subsidized.

The question thus is, what are Pakistanis going to export and import from India? Will Pakistan be able to balance trade and protect its industry from the vagaries of competition, dumping or smuggling, which are already rampant? Is Pakistan going to import daal-mirch masala and paan-chalia or wheat, sugar or cotton because they are cheaper there? What about Pakistan's own agriculture, farmlands, farmers and labourers then? Is Pakistan going to import household appliances, electronic goods, cycles, motorcycles, cars, automotive parts and at what cost to the economy? And, if so, what about Pakistan's own investment in these embryonic industries, further industrialisation and industrial workers?

Economic sovereignty prevails over political sovereignty. This has been proven time and again. A case in sight is that of USSR: their 'might' collapsed like a house of cards. It is no more a contender for a world power although it still possesses all that nuclear weaponry. The USSR always imported wheat and other materials from the USA and the Europe. Dependence for food and other necessities of life proved to be the last straw on the camel's back. USSR became economically weak and ultimately lost its contest for global dominance despite all its weapons. Isn't there a lesson to be learnt from this?

There are these and many other soul-searching questions which must be answered earnestly before embarking on free trade, free competition, free economy and trade with India.

Source: Shirazi, Yusuf, H., 'Soul Searching', Money Matters, The News, Karachi, 2 July 2012.

Box 24.6
Two Views on Trade with India

Two contrasting views were presented by two columnists soon after the granting of the MFN status by Pakistan to India.

I. Munir Akram writes:

On Nov 1, 2011, the Pakistani cabinet decided to `grant` Most Favoured Nation (MFN) status to India. MFN is the most misunderstood concept in trade legislation.

All it means is that a World Trade Organization (WTO) member will treat every other member equally in terms of tariff and other trade conditions. In fact, the Charter of the GATT (General Agreement on Tariffs and Trade), WTO`s predecessor, envisaged trade relations between the newly independent `dominions` of India and Pakistan as a customs union—a more intimate, duty-free trade arrangement.

However, history conspired to create a very different trade relationship between Pakistan and India. First, their currencies were de-linked and then progressive barriers—tariff and non-tariff—erected to restrain bilateral trade. After the 1965 war, trade was banned altogether by both sides. Such restriction is also legally sanctioned by the Gatt/WTO charter, in its `national interest` clause.

The road since 1965 has been long and hard. It was only in the 1980s that Pakistan and India took baby steps to open up trade, item by item, with lists numbering less than 50 items. It was only a decade ago, when India gained confidence in its ability to compete against Pakistani goods, that it offered MFN status to Pakistan.

Pakistan did not reciprocate, for economic and political reasons. On the one hand, there were (and still are) fears that cheaper Indian manufactures—textiles, engineering goods—would put Pakistani producers out of business. More importantly, Pakistani leaders did not want to be seen normalising trade while the Indian army was engaged in brutal repression in Kashmir. Trade normalization was explicitly linked to progress on Kashmir and other outstanding issues.

Clearly, this linkage has now been jettisoned. On Kashmir, peace and security, Siachen and Sir Creek any change in India`s position has been for the worse. Of course, it is no secret that the western powers have strongly pressed Pakistan to normalise trade with India, arguing that this will contribute to improving political relations—the reverse of Pakistan`s long-standing position.

India`s only `gesture` was to drop its mean-minded veto in the WTO against the trade preferences the EU agreed to offer Pakistan to help it recover from last year`s devastating floods.

How will the reciprocal acceptance of MFN impact on bilateral trade?

Trade between Pakistan and India remains minuscule. Last year, India exported $1.5bn to Pakistan, while Pakistan`s exported $275m to India. Informal (illegal) and indirect trade is estimated to be another $3bn-$4bn. Total trade is thus around $6bn-$7bn. This is much lower than India`s $60bn two-way trade with China, but roughly the same as Pakistan`s $7bn trade with China.

It is not at all certain that two-way trade will expand significantly with reciprocal MFN treatment. Apart from the restrictions, what has constrained trade between Pakistan and India is the similarity of the two economies, which are, therefore, competitive rather than complementary. Of course, in recent years, the Indian economy has become more diversified and globally competitive. India, therefore, will have greater possibilities to enlarge exports to Pakistan than the other way around.

At present, sadly, Pakistan is unlikely to gain very much from trade liberalisation with India, or any other developing country. Simply put, Pakistan does not produce very much that it can sell abroad. It does not enjoy a price advantage in more than a handful of products. Trade is only 10 per cent of its GDP. Its volume is one-tenth that of Mexico and Brazil, countries of comparable size.

Pakistani manufacturers of textiles, pharmaceuticals and automotive parts are reportedly concerned that cheaper Indian goods—some benefiting from subsidies—could damage their industries significantly. Admittedly, the weaknesses in each of these sectors are the consequence mostly of Pakistani mistakes. Value-addition in textiles has been deliberately retarded by decades of easy earnings from yarn and fabric `quotas` in the US and EU markets. In pharmaceuticals, Pakistan—unlike India—has been held back by multinationals from producing its own generic drugs. In the automotive sector, Pakistan gave in too early to demands under WTO agreements to remove infant-industry support.

Apart from this, there is genuine concern among Pakistani traders about Indian non-tariff barriers (NTBs). India is also one of the most prolific users of the WTO`s anti-subsidies and anti-dumping mechanisms designed to block or hold back artificially cheap imports. At the same time, many Indian products benefit from government subsidies, such as free electricity. Pakistan does not have in place the bureaucratic machinery to implement the trade `defence` measures allowed under WTO rules. Nor does the Pakistani exchequer have the financial capacity to support production subsidies and other official mechanisms for export expansion.

Pakistan`s aim should be to negotiate special arrangements—as it has done with China—to take into account India`s advantages, especially in certain industrial and other manufactured goods sectors, and thus level the playing field.

In the short term, Pakistan`s advantage over India will be in certain food and agriculture sectors. Over the years, Pakistan`s wheat, rice and other agricultural commodities—whose prices were at times artificially restricted at home—have been smuggled to India (and Afghanistan), depriving benefits to both the Pakistani farmer and consumer. It is rumoured that some of the high-grade Basmati rice sold by Indian companies abroad originates in Pakistani Punjab. The `regularisation` of agricultural trade should seek to prevent such abuses, including measures to prevent and punish `cross-border` smuggling.

Another issue which Pakistani policymakers will need to consider is how to respond to Indian investment in Pakistan. Like others, Indians can invest in Pakistan`s publicly listed companies (and vice versa). Pakistan-India joint ventures could be mutually beneficial in some sectors. But some investment can be sensitive. To avoid strategic mistakes and future disputes, Pakistan will need to evolve guidelines that prescribe conditions for Indian investment and determine where it would not be acceptable for strategic reasons.

Source: Akram, Munir, 'Trade with India', *Dawn*, Karachi, 6 November 2011.

II. I. A. Rehman responded:

THE debate on the question of granting the Most Favoured Nation (MFN) status to India has been far from edifying and the danger that Pakistan may once again miss the opportunity of adopting a rational trade regime cannot be ignored.

Two decades ago, the commerce ministry submitted to the government the findings of a study that resumption of normal trade with India would benefit both the people and the government of Pakistan. The government was too afraid of the hawkish lobby to engage in a serious discussion. After 20 years, the commerce ministry has picked up the courage to offer MFN status to India and the government is still betraying a lack of will to take on the critics in a straightforward manner.

Those in favour of the move have tried to argue that opposition to MFN status for India was based on ignorance. It has also been pointed out that by treating India as a most favoured nation Pakistan will only be fulfilling its obligations under the WTO Protocol and reciprocating New Delhi's decision of 1996. As usual the debate is continuing on two planes—one economic and the other political. Those opposed to the official move reject it on both grounds.

The trade organizations are divided, though not as sharply as earlier. The president of the Karachi Chamber of Commerce and Industry says it is a misconception that opening up trade with India will harm Pakistan. He is quite optimistic about a doubling of the volume of the two-way trade. The Lahore Chamber of Commerce and Industry does not reject the MFN move but cautions against any steps at the cost of the national industry.

The most commonly advanced argument against normalization of trade with India is that the economies of the two countries are competitive and not complementary and that Pakistan's export potential is much less that India's.

Pakistan is, therefore, unlikely to gain much from trade liberalisation with India or any other country. A factor that tilts the balance against Pakistan is its lack of human resources and skills, such as India has employed to protect its interests within the WTO regime. However, it is conceded that Pakistan's misfortunes are due to its own mistakes, mainly in the form of excessive reliance on earnings from export of raw material and semi-processed products.

This analysis simplifies the issue. Is it in Pakistan's interest to persist in a system of economic management that continues to erode its export capacity on the one hand and on the other compels the industrial entrepreneurs and consumers to pay for equipment and goods more than they would if they found trading partners nearer home?

Does Pakistan have the resources to defy the world market forces and thrive on the strength of isolationist policies? The cost of liberalising trade with India is not denied but equally undeniable is the fact that such costs will increase with the passage of time.

Is it fair to increase the liabilities of the future generations only for the sake of covering up the muddle-headedness of the past and the present generations? Leave economists and traders aside, common sense alone can guide any citizen to answers in accord with the national interest and reason. True, the creation of a new trade regime cannot be a push-button affair, but wisdom lies in starting the process sooner rather than later.

While objecting to the MFN move on economic grounds no one should ignore the fact that for years illegal/informal trade between India and Pakistan has been twice as much as the trade through official channels. The gap will continue to grow and both the state and the people will be the losers.

A similar line of argument can be developed to answer those who oppose the MFN move on the ground that it will mean abandonment of Pakistan's stand on Kashmir. These critics assailed the government for ignoring the military's interest. Such elements are unlikely to be satisfied by the foreign minister's statement that all stakeholders, including the military, had been taken on board. Even if her view is contested the idea of allowing a state service the power to override the wishes of the state and the people will have to be discarded.

Is the MFN move any worse than the bargain that Gen Musharraf was reported to have struck with New Delhi? Besides, nobody has shown that by sacrificing the gains that will accrue from normalization with India, Pakistan will secure a Kashmir settlement.

As has often been pointed out there are only two ways of resolving the Kashmir issue—one by military force and the other through the international community's intervention. The military option became unavailable years ago. Even the most purblind among the defenders of the nuclear weapons policy cannot claim that atom bombs will help Pakistan wrest Kashmir from India's stranglehold.

As for international pressure for implementation of the UN resolutions by which we swear, more by habit than conviction, these resolutions were the Anglo-American bloc's reward for an unquestioning camp follower and it stopped obliging Pakistan four decades ago. As things stand today, Pakistan can bank on the support of neither the US-Nato alliance nor China nor even the so called Muslim bloc for a fair solution to Kashmir.

There is no doubt that the people of Kashmir have a just cause and to the extent their cause is supported, regardless of their views on the territory's future, Pakistan will have an objective worth struggling for—of course, short of war. This struggle cannot be conducted by an unstable, non-democratic, aggressively theocratic, politically divided and economically dependent Pakistan. Nobody will lift a finger for Pakistan unless it achieves political cohesion and economic strength under a democratic canopy.

The plea that the MFN issue should be debated in parliament appears to be reasonable. One wonders, however, whether the argument has been advanced to cover up the interest the leaders of the party concerned have always shown in fullest possible trade with India.

This does not mean rejecting the need for well-thought-out and measured steps on the road to normalization with India. It is the tendency to irrationally bar access to this path that must at the moment be resisted. An idea of the kind of emotional blackmail to which successive Pakistan governments have succumbed can be had from the following newspaper comment on the MFN proposition:

"Those concerned with the country's defence and security have described this decision (to allow MFN status to India) a

greater disaster than the Pakistan army's surrender at the time of the fall of Dhaka. According to them, giving a congenitally deceitful and dangerous enemy access to its markets under the cover of two-way traffic amounts to giving it (the eternal enemy) an opportunity to seize the foundations of the country."

The MFN move appears to be a relatively small matter when one ponders the threat to the people's socio-political-economic interests, indeed to their mental health, posed by the vendors of poison quoted above. In fact the top-most priority for Pakistan is to dismantle the self-destructive mindset developed and defended by the frequently discredited protectors of its national interest.

Source: Rehman, I. A., 'A Malicious Response', *Dawn*, Karachi, 10 November 2011.

Box 24.7

What does MFN Mean?

S. Akbar Zaidi and Professor S. M. Naseem explain what the MFN status means, and whether it actually means favouring one country or is just a less problematic nomenclature for something quite routine.

I.

The two most widely read newspapers in Pakistan, *Nawa-i-waqt* and *Jang*, both of them Urdu, mainstream and largely conservative, had almost identical headlines on Thursday. *Nawa-i-waqt*, the Lahore and Punjab-based, which is more conservative, stated: *'Kabina ney Bharat ko pasandeeda tareen mulk qarar dainay ki manzoori dey-di'*. If one did not know what the discussion which lead to this headline was about, one would translate it as follows: 'The Cabinet decides to give India the status of most *favourite* nation'. The difference between 'favoured' and 'favourite' is lost somewhere in translation.

There are numerous aspects to this decision which will have a profound impact on relations between India and Pakistan. In the most obvious of outcomes, it is expected that Pakistan will now treat India like all the other 100 countries with which Pakistan trades, when it comes to trade and economic relations.

Source: Zaidi, S. Akbar, 'Most Favourite Nation?', *Indian Express*, New Delhi, 7 November 2011.

II.

The self-inflicted controversy about Pakistan granting Most-Favoured Nation treatment to India, as mandated for all signatories of WTO—and under its predecessor, the General Agreement of Trade and Tariffs—arises from a misconception about the meaning of "most favoured."

Obviously, when two of the more than one hundred countries who signed the WTO Charter in January 1995, grant MFN status to each another, it does not imply that they are the most-favoured trading partners of each other. What it simply means is that no country can discriminate against any other WTO signatory in respect of the levels of tariffs or other restrictions it chooses to impose on its imports. In the US, the designation 'Most-Favoured Nation' has been replaced with 'Normal Trade Relations' (NTR), which avoids the linguistic confusion inherent in the former.

The most-favoured-nation (MFN) principle, is an equal-treatment principle, which requires a member to treat all the fellow members the same.

For example, if a member lowers the tariff on a given commodity to X per cent, MFN requires the tariff of the same commodity for any other member will be lowered to the same level. If a member grants to another member a certain degree of market access, patent protection or lowering of percentage ownership requirement in direct investment, MFN requires that it grant the same treatment to all other members.

The refusal of Bangladesh last week to accept a reduction in tariffs on textile imports by EU countries from Pakistan—as a flood relief concession—illustrates the application of the non-discriminatory nature of the MFN rule, regardless of the merits of Bangladeshi action.

Although India offered to Pakistan, the MFN status soon after the signing of the WTO, Pakistan dithered, on grounds that India, being a more powerful and diversified trading partner, could hurt its industries. More cogently, Pakistan's reluctance was based on the argument that India, which in many ways was a more closed economy than Pakistan until the 1990s, had generally higher tariff rates than Pakistan and placed many non-tariff barriers to protect its industries.

As a result, Pakistan maintains a fairly narrow positive list (of about 1400 items) on goods that India may export to Pakistan. On the other hand, India's tariff rates remain high, especially for goods of particular interest to Pakistan, such as textiles, leather, and the mineral onyx, and non-tariff barriers are substantial. Poor transportation linkages make trade costly, with railway and road connections inadequate and sea shipments constrained by both limited port facilities and bureaucratic regulations and restrictions. Moreover, constraints on visas and cumbersome payments and customs procedures further limit the scope for trade.

The grant of MFN status by Pakistan to India would have been a routine procedure, but for the fact that the two countries view each other with suspicion and have outstanding disputes to solve which they—especially Pakistan, in view of its perceived disadvantage as the smaller (and, impliedly weaker) trading partner—use trade as a leverage. However, this is eventually a very counterproductive use of trade, which can be used to enhance the welfare of the population at large. Trade

is neither a zero-sum, nor a non-zero sum game favouring the larger partner. It is a positive sum game which benefits both partners—although not necessarily to the same extent. Neither do the presence of territorial, ideological or other non-economic issues between two trading partners necessarily prevent the realisation of economic gains from trade.

Estimates of total trade (exports plus imports) between India and Pakistan, both formal and informal, hover around a paltry $10 billion, amounting to less than one per cent of their world trade; in 2008 it amounted to a little more than $2 billion, up from a paltry $500 million in 2000, shrinking drastically from the early years after the partition. The potential remains very high. There have been a number of empirical studies using gravity models to assess the effects of Safta on interregional trade. Based on these studies, India-Pakistan trade could increase up 20–50 times its current level, based on varying assumptions.

A recent study, using the Peterson Institute for International Economics (PIIE) gravity model, shows that formal trade alone between India and Pakistan could expand roughly by 20 times greater than recorded trade.

Source: Excerpts from Naseem, S. M., 'The MFN Brouhaha', *Economic and Business Weekly, Dawn*, Karachi, 14–20 November 2011.

Box 24.8

How do Pakistani Businessmen View the Granting of the MFN Status to India?

Amir Zia and Ishrat Husain present views of Pakistani businessmen about trading with India.

I.

The overwhelming response of business leaders remains in favour of boosting trade ties which they see as beneficial for both nations, dispelling the impression that Pakistan, being smaller in size, won't be able to compete with its giant neighbour.

Wajid Jawad, a leading businessman and former chairman Export Promotion Bureau, says China enjoys a special status in trade with Pakistan, but the local businesses have managed not just to stay competitive but also to benefit from this relationship.

'Because of proximity, Indian imports will be cheaper and benefit Pakistani consumers,' he adds. 'Pakistani goods will also get an access to a billion-plus market, which will result in capacity utilization and trigger growth.'

However, the two sides need to cover a lot of ground and will have to walk through a political and bureaucratic minefield to realise the dream of enhanced trade and reap its benefits.

Islamabad has already extended the MFN status to more than 150 countries. Pakistani officials say it is a misperception that the local markets will be flooded with Indian goods if India is given the same status.

'MFN only provides equal and non-discriminatory treatment. It does not offer any sort of tariff concessions to a specific country,' says Naeem Anwar, a leading international trade economist. 'Pakistan's refusal to extend MFN to India is based on the fact that our products are denied market access through the NTBs, which means the benefits of MFN granted by India are being circumvented. We seek removal of these NTBs for granting MFN.'

Pakistani businessmen are of the view that any Indian product, having a demand in the Pakistani market, reaches here anyway by a formal channel or a third country. By granting MFN, Pakistan will not expose any new industry to competition but only divert the third-country trade to the formal channel, they say.

Anwar says that Pakistan has always been saying New Delhi denied market access to Pakistani goods by installing the NTBs, which nullifies the benefits of MFN granted by India.

In a joint statement issued after the talks, India for the first time agreed to look into the NTBs which, according to Anwar, implies that the Pakistani concern was genuine. 'These NTBs are not traceable to one source or document,' he insists. 'They include administrative procedures, policy restrictions, personal conduct of customs officers, quality and standard regulations, security formalities and hidden subsidies.'

He also underlines the importance of a comprehensive study in order to list these NTBs as well as to point out those which are Pakistan-specific.

The Commerce Ministry sources say the two countries agreed to set up a Working Group to investigate, examine and analyse the NTBs and recommend measures to remove or minimise them at the earliest.

Pakistani business leaders say the biggest hurdle to the market access in India is their visa regime.

Amin Hashwani, a leading businessman, says the delays in visas remains the biggest discouragement for Pakistani exporters. 'After the Mumbai terrorist attack, applicants have to wait sometimes up to two months to get their visas.'

Pakistani officials estimate more than 80 per cent visa applications of Pakistani businesspeople were rejected without assigning any reason, in 2010, compared with 8 per cent rejection by Pakistan during the same year.

'The remaining 20 per cent Pakistanis are discouraged by city restrictions, police reporting requirement and less-than-necessary days of stay in their visas,' says an official of Pakistan High Commission, New Delhi.

'Next, the businessmen have to seek hotel accommodation in India which means going through an entire documentation requirements and facing the inconsiderate authorities all of which makes sure they don't come back again,' he says.

Under such circumstances, says Anwar, it is not just difficult but almost impossible to strike business deals. 'It's ironical that

on the one hand you grant the MFN status to Pakistan and on the other you deny us entry what with your visa policy!'

Pakistani officials also claim visa processing at Pakistan High Commission in New Delhi is criteria-based, non-discriminatory and evenly applicable.

As Hashwani puts it, Pakistani exports to India suffer because of a lengthy clearance procedure by the Indian authorities. 'A pre-inspection certificate should be enough, but the Indian authorities have a lengthy process for clearing goods, which involves inspection and laboratory tests on arrival.'

Then there are specific duties on certain goods which usually hurt Pakistan, he adds. On paper, these duties range between 20 to 25 per cent, but practically they are between 50 to 60 per cent due to specific or minimum import duties.

No wonder, the trade balance between the two countries remains hugely in India's favour. Indian exports to Pakistan are 300 to 400 per cent higher than Pakistani exports to India.

However, Pakistani products have a great potential in the Indian market. 'We remain competitive in terms of price, quality and other commercial parametres,' says Anwar. 'Our home textiles, woven fabric, ladies' garments, footwear, surgical instruments, sports goods, inorganic chemicals, fruits, marble and onyx, and gypsum have a huge market if the NTBs are removed.'

Given the peculiar dynamics of Pakistan-India relations, trade and economic interests can go a long way in easing tensions and creating powerful lobbies, having stakes in peace between the two countries. If economy takes the centre stage, it will work as a catalyst in the resolution of long-standing disputes and issues.

Source: From Zia, Amir, 'A Favoured Option', *The News on Sunday*, Karachi, 15 May 2011.

II.

[A] focus group consultation with the businessmen engaged in Automobile, Chemicals, Pharmaceuticals and Textiles sectors etc. held at Karachi and Lahore during early 2012 revealed strong reservation about the non-tariff barriers imposed by India. According to them, Technical Barriers to Trade (TBT), Sanitary and Phyto-Sanitary Measures (SPS) are in fact acting as powerful determents to exchange of goods. Unless these are rationalized and simplified the smooth flow and desired level of Pakistani exports from Pakistan will be hindered Table below shows the Indian non-tariff barriers Pakistani exporters have identified.

Indian Non-tariff barriers

- Sanitary and phyto-sanitary measures
- Technical barriers to trade
- Quotas and Import licenses on 600 items
- Aggressive use of safeguard and anti-dumping measures
- Frequent invocation of countervailing duties
- Stringent license requirements from the Bureau of Indian Standards
- Multiple custom clearance requirements
- Non-standard custom valuation methodology
- Stringent and lengthy certification requirements
- Restrictions on rail movement of goods
- Complicated and restrictive visa requirements
- Long dwell times at ports and border points
- Transit restrictions
- Absence of testing labs at the border crossing points
- State governments' restrictions on use, sale, and consumption of certain goods
- Uncertainty about inter-state movement of goods
- Non-acceptance of letters of credit issued by Pakistani banks

In addition to the general reservations expressed about the above NTBs there were sector specific grievances that are briefly summarized in the following paragraphs. Some sectors such as Textiles were, on the contrary, quite upbeat about the prospects of their industry.

The Pharma industry's main concern was that India has the advantage of having a reservoir of essential raw materials and large economies of scale that will ease out their products due to lower costs of production and distribution of competing products from across the border. Laxity in enforcement of standards would also bring in drugs of dubious quality at low prices edging out some of the local substitutes from the market. Quality Control measures in Pakistan are not too stringent and was argued that arrangements have to be put in place to apply the same quality standards effectively to Indian products as India has against Pakistani products.

Agriculture sector was concerned about many kinds of hidden and implicit subsidies granted by several State Governments in India such as on electricity for tube wells. These subsidies would not provide a level playing field for Pakistani agriculture producers to compete. They also pointed out that the May 2006 notification of Super Basmati by the Indian Ministry of Commerce has been challenged by Pakistani exporters in 2008 and the case is still pending before the court despite a passage of four years. Barriers in the movement of trucks across the state boundaries and the consequential delays do damage perishable commodities.

In the Automotive sector, there is a clear difference of opinion. Some of the Japanese companies favour the opening of trade as they can import components and parts at much cheaper rates from India compared to Japan. The Manufacturers of auto parts are opposed to the idea because they believe that Indian auto parts will flood the Pakistani market and decimate the local industry. Efficient and low cost Pakistani exports would still be at a disadvantage as Indian assemblers have a tendency to prefer locally manufactured parts and have entered into long term agreements with these local firms. The question of switching from their partners to other suppliers, however competitive they may be, does not arise.

Chemicals and synthetic fibre sector argued that India was having a surplus of fibre which was equal to 80 per cent of the local demand in Pakistan. They could simply dump them in the Pakistani market as the enforcement regime of Anti-dumping laws was quite weak. The domestic fibre industry which has recently invested hundreds of millions of dollars in expansion of the capacity would suffer financially.

Textile manufactures were by and large optimistic that on price and quality they can capture a significant share of Indian

market provided the Indian textile industry does not use the Government machinery to thwart their inroads by different kinds of administrative and restrictive practices or non-tariff barriers. Some of the cotton lawn, home textiles and bed wear manufacturers were already exploring the opportunities for joint ventures with Indian partners to open retail outlets for selling those products which are in high demand. Imports of textile machinery from India will be cost efficient as compared to importing it from other parts of the world. Some of the garment and knit wear and other value added manufacturers expressed the concern that their Indian competitors were receiving various hidden subsidies and the level playing field was not even.

While it was explained that the non-tariff barriers were not Pakistan-specific and were applicable across the board the opponents of the trade liberalization narrated their actual experience with cross-border trade in the past which had not been too pleasant. Anecdotes of delay by the Customs Authorities, Testing laboratories and Bureau of Indian standards and Railways causing losses to Pakistani exporters were cited at these meetings. When it was pointed out that the bureaucratic indifference and inertia and hassle formed part of the administrative culture in the two countries that had inherited the common civil service it was asserted that the difference in the attitude towards Pakistani exporters was quite stark.

Source: From Husain, Ishrat, 'Managing India-Pakistan Trade Relations', Paper presented at the Woodrow Wilson Centre Conference on Pakistan-India Trade in Washington, D.C., 23 April 2011.

Box 24.9

Has India Been Granted MFN Status or Not?

I.

Pakistan-India trade normalization process that commenced with great enthusiasm appears to have hit snags and phasing out of negative list by 31 December 2012 as promised by Islamabad is in doubt. Background interviews with stakeholders indicate that there is no such official instruction to any concerned Ministry or department from the Prime Minister, the President or the GHQ to halt progress on trade normalization process with India however there are indications that the process of normalization has stalled.

Indian High Commissioner, Sharat Sabharwal, last week met Acting Secretary Commerce, Munir Qureshi, and expressed his concern regarding non-compliance of decisions taken at the Commerce Secretary level talks a couple of months ago by Pakistan. For instance, Pakistan had promised to open Wagha border for all kinds of goods imported from India by October 2012 but this decision has not been implemented so far. 'India has implemented the agreed decisions but Pakistan has yet to fulfil commitments made at the meeting,' said an official who is aware of all developments.

According to the agreement, in the first phase, India had promised to reduce SAFTA sensitive list by 30 per cent before October 2012, in lieu of opening of Wagha border. In the second phase, India has to reduce SAFTA sensitive list by additional 30 per cent by November 2012 after which Pakistan will be required to phase out negative list by 31 December 2012. India has to eliminate entire sensitive list in five years.

'Pakistan''s non-compliance of agreement has compelled India not to reduce sensitive list by an additional 30 per cent, which shows trade normalization process has been halted,' said another official on condition of anonymity. Commerce Ministry, sources said, will submit a summary to the Federal Cabinet prior to 31 December 2012 deadline along with update on normalization of trade with India but would leave the final decision to the Cabinet, which is the competent forum to take such decisions.

Insiders claim that agriculturists'' lobby in Punjab, which was not engaged in the process for the past two years, has now come forward in opposition to trade normalization process. 'Why agriculturists were sleeping for the last two years? Current hue and cry indicates that they are being used by political forces or those elements that are not in favour of trade normalization with India,' said an analyst who requested anonymity.

However, Chaudhry Hamid Malhi, a representative of agriculturalists'' lobby, told Business Recorder that agriculture community had not been taken into confidence prior to the agreement with India. 'Farmers are not against trade with India but expect to be protected against the highly subsidized agriculture products of India. On an average, each agriculture hectare gets a subsidy of $300 per year in India,' he added. This works out to around PKR 11,900 per acre of subsidy or for a 30 maunds average production of any commodity. Indian farmers have a comparative advantage of Rs. 400 per 40-kg.

This implies that unless each agri product imported from India is not subjected to an import duty @ 400 rupees per 40-kg, the Pakistani farmer producing the same product would be at a disadvantage. He further argued that reliance on Indian goods should never be an option. The Bangladesh experience of 2010–11 when 5 lakh tons of wheat & rice were transacted to be exported by India to Bangladesh to avoid a food scarcity situation never materialised even after an advance payment.

According to him, recent cotton export restrictions, the cement import impediments and other tariff and non-tariff barriers by India that protect its agriculture and industry also need to be kept in mind. Even the US has complained at the WTO of Indian hidden undisclosed trade barriers and export subsidies. Pakistan''s trade imbalance is in India''s favour and has increased from 80:20 to 85:15 in the last one year.

Officials in Commerce Ministry maintain that the growers have never raised any specific objection to trade normalization with India before and their recent objection may be for political reasons as the Punjab government has come forward in support of agriculturists.

Source: Ghumann, Mushtaq, 'Has Indo-Pak Trade Normalization Process Stalled?', *Business Recorder*, Karachi, 4 December 2012.

II. Sharif urged to grant MFN status to India

The leadership of the SAARC Chamber of Commerce and Industry (SAARC CCI) from India and Pakistan chapters have urged upon the newly-elected Pakistan government to announce most favoured nation (MFN) status as a priority matter as it is one of the strongest confidence-building measures between the two economies of South Asia, a statement said.

Vikramjit Singh Sahney, the incumbent president of the Saarc CCI, who is scheduled to visit Pakistan as a member of India-Pakistan Business Council (IPBC) to attend the inaugural meeting of the joint IPBC, scheduled at the end of June, said that the MFN is one of the fundamental principles of the multilateral trading system and each member nation of the World Trade Organization (WTO) is obliged to grant MFN status to other member country under Article I of GATT, it said.

'India perceives MFN as an economic obligation and conferred this status to Pakistan in 1996, soon the enactment of the WTO agreement,' the Saarc CCI president said, adding that further delay will diminish spirit of high-level dialogues between the two countries.

He also said that Prime Minister Nawaz Sharif has already expressed his vision to further improve bilateral relations with India and announcement to grant MFN status will help bridge trust among the two neighbouring nations.

Pakistani members of IPBC, Iftikhar Ali Malik, vice president of the Saarc CCI (Pakistan Chapter) and SM Muneer, president of India-Pakistan Chamber of Commerce and Industry, have reiterated that the MFN status should also be perceived as the economic obligation being an active member of the WTO.

They said that granting MFN status to India has misleading interpretation in Pakistan. 'MFN does not mean that India is the 'Most favourite' nation, it simply conceding similar trade concessions as accorded to other WTO member countries.

They urged on the Indian government to remove country specific non-tariff barriers, allowing Pakistan exports to make niche in big Indian market.'We have the understanding that some of our industrial sectors may face challenges if trade is open under the MFN; however, options such as setting up joint ventures in such areas can be explored,' they said, adding that Pakistani enterprises need to enhance their competitiveness and productivity, as is was the demand of the prevailing free trade regime.

Source: http://www.thenews.com.pk/Todays-News-3-185679-Sharif-urged-to-grant-MFN-status-to-India

III. India reminds Pakistan about MFN status, urges cooperation

The Government of India on Wednesday once again urged Pakistan to fully implement the roadmap for normalising economic cooperation, including granting the country Most Favoured Nation (MFN) status.

According to details, Indian High Commissioner Sharat Sabharwal said, 'The economic roadmap needs to be fully implemented for more trade and investment between the two neighbouring countries.'

He was addressing a farewell luncheon hosted for him by the Karachi Chamber of Commerce and Industry. The Indian envoy referred to the joint statement issued after the seventh round of talks on commercial and economic cooperation between the commerce secretaries in September 2012 and said it laid out the roadmap for normalising and increasing economic ties.

In the joint statement, it was agreed that Pakistan would grant MFN status to India by December 2012. In return, India had agreed to bring down its SAFTA Sensitive List to 100 tariff lines at six-digit level by April. Sabharwal, who served as the Indian envoy for four years, said New Delhi had implemented several decisions, including allowing investments from Pakistan and reducing the SAFTA tariff line.

After the formation of the new government in Islamabad, he said, India was hoping that Pakistan would implement the roadmap for cooperation. He welcomed Prime Minister Nawaz Sharif›s remarks about trade with India and said that similar sentiments prevailed across the border.

After trade talks between India and Pakistan were initiated in September 2011, there were several positive developments that resulted in the first visit to Pakistan by an Indian commerce minister in February last year, he said. These developments also resulted in improved bilateral trade. 'Exports from Pakistan to India registered growth,' he said.

Asked about recent tensions between the two countries, Sabharwal said, 'Both the sides have trust deficiency. . . . Once relations improve, everything will go better.'

Source: http://www.pakistantoday.com.pk/2013/06/12/news/national/india-reminds-pakistan-about-mfn-status-urges-cooperation.

24.6 Summary and Further Reading

24.6.1 Summary

There are no economic arguments which ought to restrict India and Pakistan from having a fruitful economic and trading relations with each other. The benefits of trade will accrue to both governments and their people, but probably, more so to Pakistan than India. Even though there are numerous hurdles between the two neighbours, trade does take place, and rather surprisingly, India does emerge as a non-trivial trading partner for Pakistan. With the possibility of greater regional economic and trade cooperation following the Twelfth SAARC Summit in January 2004 and the signing of SAFTA, there was a hope at least, that better economic and trade relations would take place between these two countries which have fought four wars. Moreover, a key argument of this chapter has been that there exists a substantial peace dividend from better relations between these two countries, which will have an impact on domestic politics and institutions as well.

At a time when countries are facing competition from the rest of the world under the guise of globalization, India and Pakistan, as well as the smaller South Asian countries, should think of forming a regional trading bloc. This chapter also discusses the economic and political arguments which discuss the issue of regional trading arrangements (RTAs), and in the case of India and Pakistan argues, that economic factors do not exist which should hamper the formation of such an entity, but politics does complicate things. Regional integration may generate economies of scale and competitive gains under imperfectly competitive market structures. It will increase the flow of foreign direct investment because of larger market size, the elimination of contingent protection, etc. It can also increase the pace of member countries' industrialization. Since trade increases common interests, neighbouring countries which have security problems between them, may benefit from integrating their economies and creating a situation of mutual dependence, increasing the costs of disrupting a well-functioning system.

It is in the interest of India and Pakistan to work together against bigger adversaries. Since the past has been so uncertain and variable, it is impossible to predict what is going to happen between India and Pakistan in the next decade. If there is peace and better economic and trade relations, perhaps the 400 million people below the poverty line in India and Pakistan will see some resources and interest directed towards them. It doesn't seem logical that India and Pakistan lose existing and further opportunities for better cooperation, but it has not been common sense that has determined relations over the last 66 years. One can only hope that all this will change.

24.6.2 Further Reading

For some earlier analysis, see, Ijaz Nabi and Anjum Nasim's 'Trading with the Enemy: A case for liberalizing Pakistan-India Trade' in Sijal Lahiri (ed.), *Regionalism and Globalization: Theory and Practice* (London: Routeledge, 2001). The very useful and influential Government of Pakistan Ministry of Commerce Report of 1996 is no longer available. However, some reports and studies were prepared for the Twelfth SAARC Summit, and though not easy to obtain, should be very useful. These reports were prepared by the following five institutions in South Asia: the Lahore University of Management Sciences in Lahore, the Katmandu-based Institute of Integrated Development Studies, the Dhaka-based Centre for Policy Research, the Institute for Policy Studies in Colombo and the Confederation of Indian Industry in New Delhi. The quarterly journal, the *South Asian Journal* published by the South Asia Free Media Association in Lahore, has dedicated its March 2004 issue exclusively to economic development in South Asia and would be of great interest to researchers.

There has been far greater work on regional integration and on the possible economic relationship between South Asian countries, in India. The Research and Information System for the Non-aligned and Other Developing Countries (RIS) in New Delhi, has published the best and the most useful material in their *South Asia Development and Cooperation Report 2001/02* (New Delhi, 2002) and an earlier *SAARC Survey of Development and Cooperation 1998/99* (New Delhi, 1999)—for any scholar interested in South Asian economic and trade issues, these two publications are indispensable. Other publications include the following: I N Mukherji's monograph *Towards a free trade area in South Asia: Charting a feasible course for trade liberalization with reference to India's role*, published by the Research and Information System for Non-aligned and Other Developing Countries (New Delhi, 2003); the brief but very useful Federation of Indian Chambers of Commerce and Industry (FICCI), *Status Paper: India-Pakistan Economic Relations* (New Delhi, 2003); S K Mohanty's *Regional Trade Liberalization under SAPTA and India's Trade Liberalization with South Asia*, monograph RIS-DP No 48/2003, published by the Research and Information System for Non-aligned and Other Developing Countries (New Delhi, May 2003). The International Centre for Peace Initiatives and the Strategic Foresight Group, both in Mumbai, also published reports on similar themes; in particular, see their *Costs of Conflict between India and Pakistan* (Mumbai: International Centre for Peace Initiatives, 2004). With most organizations posting information on the internet, it might be possible to find information about these studies and these organizations on the web.

After the diplomatic breakthrough between India and Pakistan in 2004 and 2005, a number of studies were conducted in Pakistan which examined the potential of trade with India. In particular, see the very thorough and comprehensive study conducted by the World Bank: Naqvi, Zareen F. and Phililp Schuler (eds.), *The Challenge and Potential of Pakistan-India Trade* (Washington DC: World Bank, June 2007) http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/07/11/000020953_20070711135032/Rendered/PDF/402730P07493901India1Trade01PUBLIC1.pdf. Also see, USAID, *South Asian Free Trade Area: Opportunities and Challenges* (Washington DC: USAID, October 2005); Confederation of Indian Industry, *Pakistan-India/India-Pakistan CEO's Business Forum* (New Delhi: Confederation of Indian Industry, Not Dated (probably 2005); Pakistan Institute of Legislative Development and Transparency

(PILDAT), *The South Asian Free Trade Area (SAFTA): Advantages and Challenges for Pakistan*, Briefing Paper No. 8 (Islamabad: PILDAT, February 2004).

For some recent excellent work on trade between India and Pakistan done by some Indian economists, see the following two papers by Nisha Taneja and her colleagues, as well as all the references cited in these papers. See Taneja, Nisha, Shravani Prakash, and Pallavi Kalita, 'Issues in India-Pakistan Trade Negotiations', *Economic and Political Weekly*, vol. 46, no. 30, 2011; and, Taneja, Nisha and Pallavi Kalita, 'Most Favoured Nation: New Trade Opportunities for India and Pakistan', *Economic and Political Weekly*, vol. 46, no. 49, 2011.

Also see the articles in, Kugelman, Michael and Robert M. Hathaway (eds.), *Pakistan-India Trade: What Needs to be Done? What Does it Matter?*, (Washington DC: Woodrow Wilson Center, 2013); Pakistan Institute of Legislature Development and Transparency (PILDAT), *MFN Status and Trade Between Pakistan and India* (Islamabad: PILDAT, January 2012; Punjab Board of Investment and Trade (PBIT), *Implications of Trade Liberalization Between Pakistan and India* (Lahore: PBIT, May 2012); and, Federation of Indian Chambers of Commerce and Industry (FICCI), *Status Paper on Indian-Pakistan Economic Relations* (New Delhi: FICCI, February 2012).

NOTES

1. Parts of this chapter are based on two of my previous papers: see Zaidi, S. Akbar, 'Economic Confidence Building Measures in South Asia: Trade as a Precursor to Peace with India', in Ahmar, Moonis (ed.), *The Challenge of Confidence Building in South Asia* (New Delhi: Haranand Publications, 2001), and 'International Relations Theory and the Political Economy of Trade: India and Pakistan', in E. Sridharan, (ed.), *International Relations Theory and South Asia: Security, Political Economy, Domestic Politics, Identities and Images, vols. I and II*, (New Delhi: Oxford University Press, 2011).
2. See Research and Information System for the Non-aligned and Other Developing Countries, *South Asia Development and Cooperation Report 2001–02*, (New Delhi, 2002).
3. Dale C Copeland, 'Economic interdependence and war: A theory of trade expectations', *International Security*, vol. 20, no. 4, 1996, 5–6.
4. Ibid. 6.
5. From Ibid. 8.
6. Theodore H Moran, 'Grand strategy: The pursuit of power and the pursuit of plenty', *International Organization*, vol. 50, no. 1, 1996. See also Liberman, Peter, 'Trading with the enemy: Security and relative gains', *International Security*, vol. 21, no. 1, 1996.
7. From Mansfield, Edward, *Power, Trade and War* (Princeton: Princeton University Press, 1994), cited in Moran, op. cit., 1996.
8. Copeland, op. cit., 7.
9. Ibid. 7.
10. Ibid. 25.
11. Lieberman, Peter, 'Trading with the enemy: Security and relative gains', *International Security*, vol. 21, no. 1, 1996, 151.
12. John C. Matthews III, 'Current gains and future outcomes: When cumulative relative gains matter', *International Security*, vol. 21, no. 1, 1996, 112ff.
13. Ibid. 118.
14. Also see R. J. Barry Jones et al. *Introduction to International Relations*, (Manchester: Manchester University Press, 2001).
15. For an excellent assessment of these issues see Peter Robson, *The Economics of International Integration*, Fourth Edition (London: Routledge, 1998). Also see Spyros Economides and Peter Wilson, *The Economic Factor in International Relations: A Brief Introduction* (London: I. B. Tauris, 2001), which looks at both IR and trade theory.
16. Much of this discussion on PTAs is drawn from C. Parr Rosson et al. 'Preferential Trading Arrangements: Gainers and Losers from Regional Trading Blocs', www.ces.ncsu.edu/depts/agecon/trade/eight.html
17. Salvatore, Dominick, *International Economics*, 4th Edition, (New York: Endowment of International Peace, 1993), quoted in Rosson, op. cit.
18. Salvatore, op. cit., 1993.
19. Rajesh Chadha and Devender Pratap, 'The Dinosauric Blocalization versus the Multilateral Liberalization: Can the Lilliputian South Asian Free Trade Agreement Make A Difference?' Unpublished mimeograph, New Delhi, July 2003.
20. Cited in Robson, op. cit., 93.
21. Ibid. 286.
22. Ibid. 291.
23. For an earlier assessment of this theme: see Zaidi, S. Akbar, 'Economic Confidence Building Measures in South Asia: Trade as a Precursor to Peace with India', in Ahmar, Moonis (ed.), *The Challenge of Confidence Building in South Asia*, (New Delhi: Haranand Publications, 2001), and 'International Relations Theory and the Political Economy of Trade: India and Pakistan', in E. Sridharan (ed.), *International Relations Theory and South Asia: Security, Political Economy, Domestic Politics, Identities and Images, vols. I and II*, (New Delhi: Oxford University Press, 2011) and, Chadha, Rajesh and Devender Pratap, 'New Era of India-Pakistan Trade Relations: More Butter and Less Guns', unpublished mimeograph, New Delhi, 2003.
24. Average for three years, viz. 1998–2000.
25. Chadha and Pratap, op. cit., 2003.
26. Government of Pakistan, Ministry of Commerce, *Pakistan-India Trade: Transition to the GATT Regime*, Islamabad, September 1996.
27. Some countries have a negative list for traded goods, i.e. they import all commodities except those which are on this negative list, as does Pakistan when it imports from most countries. In the case of India, however, Pakistan only allows import of items on this 'positive' list.
28. Sridharan, E., op. cit., 97.
29. Government of Pakistan, op. cit., 3.
30. Sridharan, E., op. cit., 68.
31. Ibid. 70.
32. Ibid. 89.
33. Ibid. 89.

34. Government of Pakistan, Ministry of Commerce, *Pakistan-India Trade: Transition to the GATT Regime*, Islamabad, September 1996, 1.
35. Ibid., 2, emphasis added.
36. Ibid. 2.
37. Karachi Chamber of Commerce and Industry (KCCI), *Freer Trade with India: Its Raison d'être and Impact*, Research and Development Cell (Karachi: KCCI, March 1996), 1.
38. Ibid. 3.
39. Ibid. 5.
40. Burki, Shahid Javed, 'The Themes to be Explored', *Dawn*, Karachi, 23 January 2001.
41. Ibid.
42. Government of Pakistan, op. cit., 2.
43. Government of Pakistan, op. cit., 16.
44. Ibid. 16.
45. Sridharan, E., op. cit., 76.
46. The Government of Pakistan study cited was undertaken by the second Benazir Bhutto government, while the second Nawaz Sharif government made huge efforts to improve trading relations with India as a consequence of the Lahore Declaration.
47. See for example, my series of articles in the *Economic and Political Weekly*: 'A Benevolent Dictatorship?', *Economic and Political Weekly*, vol. 34, nos. 42 and 43, 1999; 'Democracy, Development and Dictatorship', *Economic and Political Weekly*, vol. 34, no. 45, 1999; 'Why Pakistan's Military Government Will Fail', *Economic and Political Weekly*, vol. 34, no. 49, 1999; 'The Political Economy of Peace', *Economic and Political Weekly*, vol. 35, no. 7, 2000; 'Has the Unravelling Begun?', *Economic and Political Weekly*, vol. 35, no. 24; and, 'The Last, Losing Bet' in Contemporary Essays Series, *On the Abyss: Pakistan After the Coup* (New Delhi: Harper Collins, 2000).
48. In the 2000–01 budget, the government juggled with numbers in the defence budget and transferred Rs. 26.1 billion worth of military pensions from the military head to 'general administration'. With these figures, the government showed that it had decreased the military budget, when in fact a proper calculation showed an 11 per cent increase. See Zaidi, S Akbar, 'Playing with Numbers', *DAWN*, Economic and Business Review, Karachi, 21–25 June 2000.
49. Siddiqa-Agha, Ayesha, 'Power, Perks, Prestige and Privileges: Military's Economic Activities in Pakistan', paper presented at the Soldiers in Business: Military as an Economic Actor conference, Jakarta, 17–19 October 2000.
50. *Dawn*, Karachi, 13 July 2000.
51. *Dawn*, Karachi, 3 October 2003.
52. Although this chapter focuses mainly on Pakistan's interests in improving relations with India, India's possible reasons are also important. India is trying to project an image of a responsible regional power, with ambitions of a seat at the UN Security Council. Peace, trade and normal relations with Pakistan will also serve its wider interests.
53. Saleem, Farrukh, 'Soldiers in Business', *The News on Sunday*, Karachi, 25 May 2003. See also Siddiqa-Agha, Ayesha, 'Power, Perks, Prestige and Privileges: Military's Economic Activities in Pakistan', paper presented at the Soldiers in Business: Military as an Economic Actor conference, Jakarta, 17–19 October 2000.
54. See Strategic Foresight Group, *Cost of Conflict between India and Pakistan*, International Centre for Peace Initiatives, Mumbai, 2004.

25 War, Destruction, and Aid

Pakistan has been involved, for the second time around, as a frontline state in a war in Afghanistan. No one knows how and when, or even if, this second war will come to an end. Pakistan has suffered, in numerous ways, as a consequence of its political economy and because of the wars on its western frontier. The consequences of Pakistan's involvement and role in the first war between 1979–85, are still being felt, and that earlier war has a close linkage with the new one after 2001. These wars have changed Pakistan beyond recognition, and what Pakistan could have become, is very different from what it is today and from what anyone could have imagined in 1977, or even in 1979. It is improbable that many people who looked at Pakistan in the late 1970s, could have called it a 'rogue state', 'the most dangerous place in the world', and lots worse, two decades later. Pakistan's political leadership, its elite, but especially its military, are responsible for dragging Pakistan into the first Afghanistan war as well as into the second. This chapter examines what the ongoing war in Afghanistan has cost Pakistan's economy and its people. It also examines the palliative, or compensation, paid by the US for Pakistan's services—mainly military—and underscores the point that the US assistance has been one of the factors which has aggravated the situation even further in Pakistan.

25.1 The Costs of the War on Terror

The annual *Pakistan Economic Survey 2010–11*, released on 2 June 2011, for the first time ever and a decade after 9/11, had a two-page Special Section entitled 'Cost of War on Terror for Pakistan Economy'.[1] For a decade, Pakistan had been embroiled in the US's War on Terror in Afghanistan and on Pakistan's borders, and Pakistan had become the centre of the storm in many ways, almost all deleterious. The political economy impact of the War on Terror, and the subsequent Talibanization of Pakistan with the rise of militancy within Pakistan, has been discussed in a large number of books, but there was little analysis of the economic consequences, especially analysis initiated by the government. There had been many newspaper accounts of what the war was costing Pakistan and whether Pakistan had been adequately compensated for its role in assisting the US and its allies in Afghanistan, but this was the first analysis which was made public. Also, interestingly, in the *Economic Survey* which followed the year after, in 2011–12, this Special Section had been dropped.

The Government of Pakistan stated that in the decade from 2001 to June 2011, as many as 35,000 Pakistani civilians, and 3,500 Pakistani security men had been killed as a consequence of the War on Terror. These numbers were far higher than the deaths of US and allied forces fighting directly in the War on Terror in Afghanistan. Pakistan, which was not in the direct ambit of the war, had lost far more civilians and personnel than the arena of war itself. Apart from the human lives lost, there was

> destruction of infrastructure, internal migration of millions of people from parts of north western Pakistan, erosions of investment climate, nose, diving of production and growing unemployment and [which] above all brought economic activity to a virtual standstill in many part of the country. Pakistan had never witnessed such devastating social and economic upheaval in its industry, even after dismemberment of the country by direct war.[2]

Being a frontline state for the second time, after the first Afghanistan invasion by Soviet troops in 1979, this time the consequences were perhaps more severe. The Government argued, that the 'War disrupted Pakistan's normal trading activities, as the cost of trading increased substantially because of higher insurance cover. Consequently, economic growth slowed, demands for imports reduced with consequential decline in tax collection and inflows of foreign investment were naturally adversely affected, accentuated by the travel bans issued by western governments to its entrepreneurs'.[3] The government's analysis argued that this war did serious damage to Pakistan's economy, but also to the country's social fabric as well. In 2011, the *Economic Survey* stated that 'obviously, continuity of War will continue to bleed the economy and society of Pakistan'.[4] That was 2011 and at the time of writing, the war continues unabated with no sign of it coming to a halt.

The Government of Pakistan during General Pervez Musharraf's regime, without doubt the single biggest beneficiary of the US's war—see Chapters 18 and 26, on the macroeconomics of the military government, and on the political economy—estimated when the war began on 7 October 2001, that it would come to a halt by December 2001, and that 'normalcy will resume from January 2002!' It estimated the cost of the war to Pakistan in 2001/02 of as much as $2.669 billion. In 2009/10, this annual cost to Pakistan was calculated by the government to be $13.6

billion, rising to $17.8 billion in 2010/11. Table 25.1 below show the annual loss to Pakistan's economy since 2001. In June 2011, the Government of Pakistan estimated that the decade-long War on Terror cost Pakistan $67.93 billion. The consequences of the war even after a decade included some of the following long-term effects, which still continue:

> . . . the western countries including the United States continued to impose travel ban for their citizen *(investor, importers etc.)* to visit Pakistan. This has affected Pakistan's exports, prevented the inflows of foreign investment, affected the pace of privatization program, slowed the overall economic activity, reduced import demand, reduced tax collection, expenditure over-run on additional security spending, domestic tourism industry suffered badly, hundreds; and thousands of jobs could have been created had economic activity not slowed as well as thousands of jobs were lost because of the destruction of domestic/foreign tourism industry; destruction of physical infrastructure (military and civil) massive surge in security related spending; migration of thousands of people from war affected areas and the associated rise in expenditure to support internally displaced persons.[5]

Table 25.1
Cost of War Estimate in 2001/02 and 2010/11 ($ billion)

	2001–02	2010–11 (Est.)
Exports	1.40	2.90
Compensation to Affectees	0.00	0.08
Physical Infrastructure	0.00	1.72
Foreign Investment	0.15	2.10
Privatization	0.50	1.10
Industrial Output	0.11	1.70
Tax Collection	0.25	2.10
Cost of Uncertainty	0.10	2.90
Expenditure Overrun	0.11	1.60
Others	0.10	0.90
Total:	2.72	17.82

Cost of War (2001–2011)

Years	Billion $	Billion Rs	% Change
2001–02	2.669	163.9	–
2002–03	2.749	160.8	3.0
2003–04	2.932	168.8	6.7
2004–05	3.410	202.4	16.3
2005–06	3.986	238.6	16.9
2006–07	4.670	283.2	17.2
2007–08	6.940	434.1	48.6
2008–09	9.180	720.6	32.3
2009–10	13.560	1136.4	47.7
2010–11*	17.830	1528.0	31.5
Total:	67.926	5036.8	

* Estimated on the basis of 8 months actual data
Source: Government of Pakistan, *Pakistan Economic Survey 2010–11* (Islamabad: GOP, 2011), 220.

It is impossible to estimate exactly how much the War on Terror has cost Pakistan, and all estimates will be incorrect depending on assessments, assumptions and based on the costing of numerous factors, such as human life—see Box 25.1. The Government of Pakistan's estimates face the same scrutiny, but can also be manipulated by the government as a partial excuse for its own policy failure. The PPP government from 2008, could very well argue that the War on Terror was responsible for the poor showing of the economy, and it would be correct in making such claims, up to a point—some of these issues are discussed in Chapter 18 on the performance of the Pakistan People's Party regime from 2008 onwards. An independent estimate of the costs of the War on Terror by Hafiz Pasha, are also worth examining.

Hafiz Pasha has estimated that the War on Terror cost Pakistan in 2007/08, Rs. 380 billion or $6 billion, which was lower than the government's estimate of $6.94 billion for the same year.[6] Unlike the Government of Pakistan study, Pasha examined some of the consequences of the costs borne by Pakistan, arguing that, higher 'security expenditures runs the risk of 'crowding out' other expenditures related to the provision of basic social and economic services and thereby having an adverse impact especially on the lower income groups'.[7] Looking at the regional and income effects of the war, he argues, that 'the negative implications for the relatively poor include the loss of property and livelihoods in the affected areas which are among the most backward regions of the country, primarily as a consequence of dislocation of economic activity, including in the labour-intensive sector of tourism. The human dimension is manifested most acutely not only in the loss of life but also in the emergence of large numbers of IDPs'.[8]

Examining the costs as well as the so called 'compensation' or aid given to Pakistan, Pasha concluded that in 2007/08, 'the inflow of concessional assistance from the US was about $1.9 billion, whereas the cost is over three times higher at $6 billion. There has, therefore, been substantial under-compensation for Pakistan's participation in the 'War on Terror', which has been limited largely to reimbursement only for the costs of military operations. This, at least, partly explains the lack of some ownership of the war effort'.[9] It is this compensation or 'aid' which we now turn to, and examine the political economy of US aid to Pakistan.

25.2 War and Aid: Who Benefits from US Aid to Pakistan?

What would seem like a straightforward relationship and simple arithmetic, and should be a win-win situation for both, with the US government providing aid to the Government of Pakistan and to its people, appears to be a far more complicated and complex issue than one could

Box 25.1

Pakistani Perceptions and Estimates of the War on Terror

Pakistani politicians and business actors have come up with their own calculations about what the War on Terror has cost the country. M. Rafique Goraya writes:

Various government and non-governmental organizations, commercial and industrial chambers and experts have prepared reports about socio-economic costs of Pakistan's fight against terrorism during the past five years. According to the Pak-US Business Council report (2009), Pakistan is the prime victim of Afghanistan's instability, and its economy has so far suffered directly or indirectly a huge loss of 35 billion dollars.

'Moreover, due to widespread unrest and political uncertainty in Afghanistan, a large quantity of Pakistani food items/ commodities is smuggled to Afghanistan, which ultimately leads to acute food grain scarcity within the country,' said the report.

According to the Finance Ministry, Pakistan suffered directly or indirectly the loss of Rs. 2,080 billion in the war against terror from 2004–05 to 2008–09. It was around Rs. 484 billion during the 2007–08 financial year, which badly affected the country's socio-economic development.

It is estimated that it would increase to Rs. 678 billion during 2008–09 financial year. The cost includes both direct and indirect on account of loss of exports, foreign investment, privatization, industrial output, soft image and tax collection. The report further indicates that the expected direct cost of war on terror will reach Rs. 114.03 billion in 2008–09 from Rs. 108.527 billion last year.

The indirect cost will increase to Rs. 563.760 billion from Rs. 375.840 billion. According to the report, the anti-terrorism campaign overstrained Pakistan's budget, as allocation for the law-enforcement agencies had to be increased significantly, curtailing the funding for development projects since 9/11.

In its poverty reduction strategy papers-II, the Finance Ministry revealed that Pakistan's participation in the anti-terrorism campaign had led to massive unemployment in the affected regions, which had ultimately increased rural poverty too. It had reached 37.5 per cent from 23.9 per cent in 2007–08, said the report.

In a well-researched report, former senior Vice-President of Lahore Chamber of Commerce and Industry (LCCI) Sohail Lashari of SOZO parks said that the Swat war had displaced two million residents, increased unemployment manifold, discontinued education of youth, badly damaged infrastructure, finished tourism—the main source of income generation of the area—sparked violence in other parts of the country, and stopped supply of essential raw materials from Swat like marble, gem and jewellery and furniture industries, besides fresh fruits, vegetables and other hilly food items to other parts of the country.

Lashari said that frequent bombings, deteriorating law and order situation and displacement of the local population, had taken a toll on the socio-economic fabric of the country, especially the embattled Northern areas. Due to deteriorating law and order situation and high political risk, the World Bank had blocked lending for two key loans, of at least 834 million dollars, market-based loans, which might increase serious economic problems for the country, he said.

Meanwhile, the experts say that since the start of the anti-terror campaign, an overall sense of uncertainty has prevailed in the country and it is at its peak in NWFP and Fata. It has contributed to capital flight and slowed down economic activities, making foreign investors jittery.

The foreign direct investment (FDI) has been adversely affected by the ongoing anti-terrorism campaign in Fata and other areas of the NWFP. Pakistan's participation in the international campaign has led to an excessive increase in the country's credit risk, due to which recently, the World Bank has lowered our credit rating, say the experts.

The former LCCI Senior President said that the business activity in NWFP was at its lowest ebbs and the Sarhad Chamber of Commerce and Industry (SCCI) had requested government to declare the province a war-affected zone. The SCCI chief said 3,500 industrial units were functioning in the province in 1995, while the number had shrunk to 600 in 2009, and that the terrorist activities had halted commercial activities.

Meanwhile, a Harvard study (December 2008) states that higher levels of terrorism risk are associated with lower levels of net FDI and Pakistan is not any exemption. In an integrated world economy, where investors are able to diversify their investments, terrorism may induce large movements of capital across countries.

According to the statistics of State Bank of Pakistan (SBP), net foreign investment has declined by 13 per cent during the first seven months of the current fiscal year, mainly due to massive outflow from portfolio investment due to of poor law and order situation and political instability in the country.

Net foreign investment has registered a decline of some 324 million dollars during the first seven months (July–January) of 2009 fiscal year. Massive outflow of 25.058 million dollars of foreign portfolio investment from the country's equity market was witnessed during the week ended on 10 January 2009. According to National Clearing Company of Pakistan Limited (NCCPL) data, the cumulative outflow of this mode of investment had increased to 49.557 million dollars from 1 January to date.

The foreign portfolio investment has been witnessing a declining trend since the beginning of 2008, as a cumulative figure of this mode of investment has recorded negative 432.458 million dollars from 1 January 2008 to 9 January 2009.

It may be added that the government is engaged in a fierce war to regain the state's effective writ over thousands of kilometres area of Mingora, Buner, Charsadda, Bannu, Peshawar, Hangu, Mardan, Upper Dir, Kohat, Dera Ismail Khan and Lakki Marwat. The tribal agencies, Khyber, Mohmand, Bajaur, Orakzai, Kurram, North Waziristan and South Waziristan have also been under attacks during 2008.

Source: Goraya, M. Rafique, 'War on Terror Costs Pakistan $35 bn: Reports', *Business Recorder*, Karachi, 24 May 2009.

imagine. One would expect that both governments benefit, with the US providing aid to fulfil its numerous objectives for different purposes, to the Government of Pakistan which benefits, since such aid helps to meet its perennial and ever-increasing revenue shortfall problems. However, if ever there was a muddled, deceptive and complicated relationship between the two countries on the basis of aid, it must be the relationship between the US and Pakistan in recent years—see Appendix 25.1 and 25.2.

From what might have been a far simpler, straightforward and transparent arrangement in the Cold War days of the 1960s and 1970s, and even in the 1980s following the Soviet invasion of Afghanistan when Pakistan first emerged as a frontline state, the aid relationship between the US and Pakistan since 2001, has been fraught with the most complicated of cross-purposes and double-speak, shrouded in mystery, with promises and expectations diverging between both parties. It is no longer clear what is the purpose of US aid to Pakistan in the post-9/11 era. In some broad sense, of course, one can argue that the US wants Pakistan's assistance in its War on Terror to campaign and root out Al-Qaeda and Taliban insurgency in the region, in Afghanistan and in Pakistan. At the same time, one would think that the US also has a keen interest in ensuring a safe and stable nuclear Pakistan, where internal stability assures a democratic future, with a progressive, liberal and development-oriented government, and that there is peace in Pakistan and with its neighbours. One could then argue perhaps, that if such objectives are achieved, the US benefits from giving its taxpayers' money to Pakistan.

Similarly, one would assume, that the Government of Pakistan also benefit from aid, since this would help in making the region in and around Pakistan safer, more secure and stable, with militancy and terrorism being routed out, and that developmental aid would be used by the Government of Pakistan carefully, providing assistance to its people. In such a scenario, both the US and Pakistan, their governments and their people, would be clear beneficiaries of this aid from the US to Pakistan. However, as this chapter argues, given the nature and form of the aid relationship between the US and Pakistan, it is not so obvious what the objectives and purpose of US aid to Pakistan really are, who it actually benefits, and whether, in fact, if this aid goes against the interests of both, or either, country, benefitting neither. *US aid to Pakistan may, in effect, have made things far worse for all supposed beneficiaries.*

We begin with a brief history of aid given to Pakistan in years following independence, but the main focus here, is the nature and consequences of US aid to Pakistan in recent years, particularly since 2001. After a short account of aid in the past, the chapter examines how the aid relationship between the US and Pakistan has changed over the last decade, and focuses on the type of aid being given, examining the presumed objectives and how this aid is being used by Pakistan, and whether US goals and Pakistani objectives are identical, or similar, and who has benefitted from this recent aid giving/receiving relationship.

25.2.1 Fifty Years of Aid to Pakistan 1950–2002

It is not an exaggeration to state; that for much of its existence since independence in 1947, Pakistan has been an aid-dependent country, even though it is not one of the poorest countries of the world. While numbers about the amount of aid received by Pakistan from all sources are hard to come by and have always been somewhat uncertain,[10] some estimates suggest that the gross disbursement of overseas development assistance to Pakistan in the period 1960–2002 (in 2001 prices), was US$73.14 billion, including bilateral and multilateral sources.[11] In this period, almost two-thirds, of this official development assistance came from bilateral sources, with the United States providing 45 per cent of all bilateral aid given to Pakistan in this period, making it the largest single bilateral donor, by far.[12] What is more critical in this regard is the fact that in the period 1990–98, US aid to Pakistan was almost negligible, implying that in the earlier period 1960–90, the importance of the US cannot be undermined. For example, while US aid disbursement to Pakistan in 1989 was US$452 million, this fell considerably in the 1990s, falling to a mere US$5.4 million in 1998.[13] In the decade of the 1990s, it was mainly Japan which made up the shortfall in aid to Pakistan, and because of this, in the overall 1960–2002 period, Japan accounted for as much as 21 per cent of total bilateral aid to Pakistan—see Figure 25.1.[14]

Almost 30 per cent of *all* aid to Pakistan—bilateral and multilateral—in the 1960–2002 period; came directly from the US. We do not have a breakdown of the source of multilateral aid to Pakistan in this period, but given the role, leverage and contribution of the US in such institutions, one could easily surmise that aid from the US has been of even greater volume and significance. The largest amount of US aid to Pakistan in this period, was disbursed between 1962/3 and 1965, peaking to almost US$2 billion in 1963/4. The lowest amount of aid given to Pakistan in the 1960–2002 period, as mentioned above, was in the 1990s, particularly between 1995 and 1998. This pattern of huge variation in US aid to Pakistan, clearly underlines the fact that far more than developmental concerns have been at play in the past, and various factors, most related to the US, some to Pakistan's actions, have had a significant bearing on US bilateral assistance to Pakistan.

In the 1950s and 1960s, US assistance to Pakistan may have arisen due to the latter's needs for development assistance as a newly independent resource-constrained country, but one cannot ignore the fact that Pakistan's leadership, particularly military leadership after the mid-1950s and more squarely after 1958, clearly aligned itself with the US on the world ideological map during the Cold War. By joining SEATO (the South East Asia Treaty Organization) and CENTO (the Central Treaty Organization) and by signing military and other pacts of cooperation with the United States in the 1950s and 1960s, Pakistan was hoping to benefit from financial and military assistance from the US. For the US, Pakistan became an ally and a hedge against perceived Soviet expansionism in the region, especially since India had become a close friend and partner to the Soviet Union, and also against communism, more generally.

Table 25.2: Direct Overt US Aid and Military Reimbursements to Pakistan: FY2002–11
Direct Overt US Aid Appropriations and Military Reimbursements to Pakistan: FY 2002–FY 2012

(rounded to the nearest millions of dollars)

Program or Account	FY 2002–FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 (est.)	Program or Account Total	FY 2012 (req.)
1206	–	28	14	56	114	–	f	212	f
CN	8	24	49	54	47	43[f]	63	288	f
CSF[a]	4,085[c]	862	731	1,019	685	1,499	h	8,881[h]	h
FC	–	–	–	75	25	–	–	100	–
FMF	674	297	297	298	300	294	295	2,455	350
IMET	5	2	2	2	2	5	4	22	5
INCLE	186	38	24	22	88	170	114	642	125
NADR	24	9	10	10	13	24	25	115	23
PCF/PCCF	–	–	–	–	400	700[g]	800[i]	1,900[i]	1,100
Total Security-Related	4,982	1,260	1,127	1,536	1,674	2,735	1,301	14,615	1,603
CSH/GHCS	77	28	22	30	34	30	28	249	2
DA	123	38	95	30	–	–	–	286	–
ESF	1,301[d]	338	394[e]	347	1,114	1,292	919	5,705	1,360
Food Aid[b]	78	55	–	50	55	124	51	413	–
HRDF	5	1	11	–	–	–	–	17	–
IDA	–	70	50	50	103	232	145	650	–
MRA	28	10	4	–	61	49	–	152	–
Total Economic-Related	1,612	540	576	507	1,367	1,727	1,143	7,472	1,362
Grand Total	**6,594**	**1,800**	**1,703**	**2,043**	**3,041**	**4,462**	**2,444**	**22,087**	**2,965**

Sources: Congressional Research Service, U.S. Departments of State, Defense, and Agriculture; U.S. Agency for International Development.
Note: Final obligation and disbursement totals are typically lower than program account appropriations.

Abbreviations:

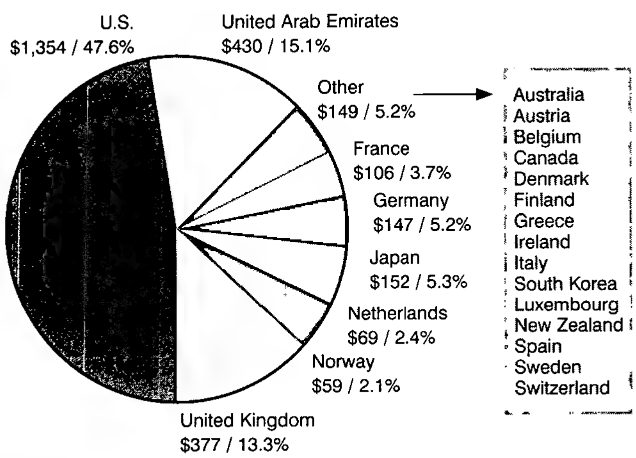
1206:	Section 1206 of the National Defence Authorization Act (NDAA) for FY2006 (P.L. 109–163, global train and equip)
CN:	Counternarcotics Funds (Pentagon budget)
CSF:	Coalition Support Funds (Pentagon budget)
CSH:	Child Survival and Health (Global Health and Child Survival, or GHCS, from FY2010)
DA:	Development Assistance
ESF:	Economic Support Funds
FC:	Section 1206 of the NDAA for FY2008 (P.L. 110–181, Pakistan Frontier Corp train and equip)
FMF:	Foreign Military Financing
HRDF:	Human Rights and Democracy Funds
IDA:	International Disaster Assistance (Pakistani earthquake and internally displaced persons relief)
IMET:	International Military Education and Training
INCLE:	International Narcotics Control and Law Enforcement (includes border security)
MRA:	Migration and Refugee Assistance
NADR:	Nonproliferation, Anti-Terrorism, Demining, and Related (the majority allocated for Pakistan is for anti-terrorism assistance)
PCF/PCCF:	Pakistan Counterinsurgency Fund/Counterinsurgency Capability Fund (transferred to State Department oversight in FY2010)

Notes:

a. CSF is Pentagon funding to reimburse Pakistan for its support of US military operations. It is not officially designated as foreign assistance.
b. P.L. 480 Title I (loans), P.L. 480 Title II (grants), and Section 416(b) of the Agricultural Act of 1949, as amended (surplus agricultural commodity donations). Food aid totals do not include freight costs and total allocations are unavailable until the fiscal years's end.
c. Includes $220 million for FY2002 Peacekeeping Operations reported by the State Department.
d. Congress authorized Pakistan to use the FY2003 and FY2004 ESF allocations to cancel a total of about $1.5 billion in concessional debt to the US government.
e. Includes $110 million in Pentagon funds transferred to the State Department for projects in Pakistan's tribal areas (P.L. 110–28).
f. This funding is 'requirements-based'; there are no pre-allocation data.
g. Congress appropriated $1.2 billion for FY2009 and $1.57 billion for FY2010, and the Administration requested $2 billion for FY2011, in additional CSF for all US coalition partners. Pakistan has in the past received more than three-quarters of such funds. FY2009-FY2011 may thus include billions of dollars in additional CSF payments to Pakistan.
h. Includes a 'bridge' ESF appropriation of $150 million (P.L. 110–252), $15 million of which was later transferred to INCLE. Also includes FY2009 supplemental appropriations of $539 million for ESF, $66 million for INCLE, $40 million for MRA, and $2 million for NADR.
i. The FY2010 estimate includes supplemental appropriations of $259 million for ESF, $40 million for INCLE, and $50 million for FMF funds for Pakistan, as well as ongoing disaster relief in the food aid and IDA accounts.

Sources: US Departments of State, Defense, and Agriculture; US Agency for International Development.

Figure 25.2
Official Development Assistance to Pakistan by Bilateral Donor: 2009
(in Millions of Dollars and in Percentages)



Source: Congressional Research Service, Organization for Economic and Development Cooperation, and USAID.

Notes: In addition to bilateral development assistance, in 2009 Pakistan received $2.6 billion from multilateral agencies, including the World Bank's International Development Association—$1.9 billion. European Union Institutions—$279 million, and the Asian Development Fund—$249 million.

It is clearly difficult, if not quite impossible, to answer such a question where military action has been ongoing for the last decade or so, and is still continuing. Even if one could answer such broad questions, such as, has Al-Qaeda in the region been routed, and are the Taliban defeated, it would be almost impossible to assess to what extent the Pakistani military played a role in this objective, and whether the purpose of giving military aid to Pakistan had been achieved, even if partially. Moreover, while it seems that there have been some victories against insurgency in Afghanistan, it is equally evident that the war has not been completely won, and that counterinsurgency and counterterrorism are still equally urgent and necessary as they may have been some years ago.

After six years of engagement in the region, the US Department of Defense conducted a review into US military aid to Pakistan in December 2007, and felt that while the US was spending 'significantly', it was 'not seeing any results'.[23] This resulted in the Department of Defense changing the focus of military funding to Pakistan by assisting the Pakistan's military with building a counterinsurgency force, and training Pakistani forces in FATA. The Coalition Support Funds are supposed to be reimbursements to the Pakistan military, which are supposed to be reimbursements 'only in the cost incurred in fighting terrorism, over and above its normal military costs. Officially, that is intended to cover food, fuel, clothing, ammunition, billeting, and medical expenses. *The United States has been assuming that Pakistan will use the funds for counterterrorism*. But up until early 2009, the United States has given Pakistan the funds *without attempting to set particular outcomes against terrorism which it expects*'.[24] Moreover, between 2002–07, the US approved for Pakistan more than $9.7 billion worth of weapon sales, and the US 'has traditionally assumed that the military equipment will be used for counterterrorism'.[25] In addition, the chains of accountability of financial flows to Pakistan from the US for military assistance, were said to be 'very complicated' with 'five different processes at work'.[26]

The US Department of Defense and Pakistani officials have both acknowledged, 'that they had never agreed on the strategic goals that should drive how the money was to be spent or how to measure success. This culture of a lack of oversight and comprehensive goals meant that the United States was offering Pakistani institutions and officials a clear incentive for misuse of US funds.'[27] Moreover, the US had 'inadequate procedures for checking how Pakistan spent the funds', and guidelines issued to US embassy staff in Islamabad did 'not require the staff to verify that the military in fact spent the money in the way described'.[28] Once the US gave the funds to the Pakistan government and to its military, 'it was no longer entitled to find out that they were spent as agreed',[29] and that the 'Pakistan military did not use most of these funds to fight terror', buying much 'conventional military equipment', leading one analyst to state that 'it is clear that Pakistan is not using the majority of US money to fight terrorism or advance the US foreign policy aims for which it was allocated'.[30] Azeem Ibrahim also cites nine 'specific examples of corruption in the Pakistani army' related to military aid from the US, and argues that 'estimates by some western military officials put the portion of illegitimately spent funds at 70 per cent'.[31] Ibrahim has argued that Pakistani counterterrorism, the purpose of US military aid to Pakistan, had failed until 2009. He argues that 'the hope was that after 11 September 2001, Pakistan would clear terrorists from within its own borders, prevent them from using areas in northwest Pakistan as a safe haven, and help to bring the Al-Qaeda leaders to justice. Despite over $12 billion towards these aims, none have been achieved'.[32]

25.3.3 Economic and Humanitarian Aid and Assistance

While military aid has been far substantial than economic aid post-9/11, economic and developmental aid was around 11 per cent of all aid after 9/11 until 2007. These funds were designated for primary education, literacy programmes, basic health, food aid, and support for democracy, governance and election support, almost all of the funds going through and disbursed through USAID. Some cash transfers were also made available to the Pakistani government, but it was not 'obliged to account for how this type of aid is spent' in the donor country, and the 'US government has traditionally given these funds to the Pakistani government without strings attached', since the Pakistani government is not obliged to reveal how it is spent.[33]

Not only has US economic aid to Pakistan been heavily overshadowed by military and security-related aid to Pakistan, but until recently, has been lower than aid provided by

other multilateral and bilateral donors. While US economic assistance to Pakistan since 2001 to around 2008/09 has focused on broad social sector interventions as highlighted above, it is only recently that the US has begun to implement longer term strategy focusing on Pakistan's frontier regions for the tribal areas' sustainable development. However, for numerous obvious reasons, any development strategy in the frontier areas has, and will continue to, face insurmountable problems, especially regarding implementation, oversight, and the like. The frontier regions are not the most hospitable terrain, and with a live war taking place in the region, most developmental efforts will be compromised. However, there is an even greater conflict in the image of the US in Pakistan, when it comes to US aid to assist Pakistan's people.

Soon after Pakistan's devastating floods in the late summer of 2010, some aid from western and donor countries was made available on humanitarian grounds. The US emerged as one of the largest donors providing in excess of $400 million. Moreover, perhaps for the very first time in many decades, the US received a highly positive image makeover in Pakistan. Private television newsreels showed US military troops flying helicopter sorties within Pakistan saving lives of Pakistanis stranded in parts of the flood-affected areas, and providing them with life-saving supplies, such as medicines and water and food. However, this positive image and photo-opportunity lasted all but a few days, when the same television channels were showing the footage of the destruction and death caused within Pakistan as a consequence of US drone attacks on the frontier regions. Any humanitarian and economic assistance to Pakistan's people will always be seen in contrast to the consequences of military-related aid and actions—see Box 25.2.

25.4 The Consequences of Aid

Given the nature and form of US aid to Pakistan—military, covert, unaccounted, unsupervised, etc.—it becomes difficult to disentangle the direct consequences—many deleterious—and benefits of aid given to the country when an often undefined and obscure 'War on Terror' or counterinsurgency and counterterrorism campaign, is being waged in different guises for a decade. Hence, many Pakistanis have argued that on account of the US's War on Terror against Al-Qaeda and the Taliban and their supporters, in Afghanistan and Pakistan, Pakistan has been drawn into 'the US's war', and has had to suffer grave consequences. They cite figures which state that as the US's role has increased in the region, and as the Pakistani military has been further drawn in, it has been Pakistanis who have suffered. They cite figures which show that in 2003, there were 189 deaths from terrorist-related violence in Pakistan, which rose to 3,559 in 2007, and higher still since; recent announcements suggest that 30,000 Pakistanis have lost their lives in this war. Many Pakistanis would argue that on account of Pakistan being drawn into this war, the war has been brought in to Pakistani cities and towns, and was also responsible for the death of a former Prime Minister seeking re-election. Clearly, it is impossible to entangle the consequences of the war, and look at counterfactuals, but there is a great deal of weight in these arguments, and the US is blamed by Pakistanis for not containing terrorism in Afghanistan and exporting it to mainland Pakistan. Such impressions do not make for a friendly relationship or a positive image, something that aid is usually expected to do.

Other opinions suggest that there has been a rise of militancy and insurgency and the rise of fundamentalism in Pakistan, and that most Pakistanis do not support such extreme tendencies. This view holds that with US support and perhaps using US pressure as an excuse, Pakistan and its military can play a leading role in rooting out terrorism in Pakistan. The drone attacks in Pakistan's northern frontier are a case in point. While Pakistani leaders publicly condemn such strikes for political mileage, there is evidence and suggestions that they not only turn a blind eye to such attacks, but favour them, allowing the US to do their (the Pakistani government's) bidding. They play good cop-bad cop depending on who their audience is.

Since there is such a large divide in perceptions of what the consequences of the War on Terror have been for Pakistan, and there is so much clouded in mystery and secrecy, it becomes difficult to comment upon whether the goals and objectives of the US and the Pakistan's military, are the same. At times it seems *that each is using the other and there is clear deceit and mistrust in this relationship.* As we have argued above, there are allegations that there has been considerable

Box 25.2

US Aid in Pakistan: Where's the Money Going?

Ben Arnoldy and Issam Ahmed in 2011 examined the nature and impact of US aid to Pakistan.

1. How much US money is in Pakistan?

The US has provided $20.7 billion to Pakistan since 2002. A little more than two-thirds of that went to military use, the remainder to civilian use. The biggest ticket item, at $8.9 billion, is something called 'Coalition Support Funds'. These are reimbursements for Pakistan's military assistance in the war on terror. The second largest chunk, $4.8 billion, falls under 'Economic Support Funds'. Most of this has gone to shore up the government's budget, either as revenue or to pay off debt to the US. Much less is spent on seemingly major US priorities: The Frontier Corps, the Pakistani force doing most of the fighting, has received $100 million. Antiterrorism and nuclear non-proliferation efforts: $90 million. 'One of the things we should be doing is training the police, but we're not doing it . . . Pakistanis are not letting us. They want the Army to do everything,' says C. Christine Fair, assistant professor at Georgetown University in Washington.

2. What has Pakistan's Army Done with the Money?

The short answer is: No one quite seems to know. The US reimburses Pakistan for costs associated with the numerous military operations launched following US goading. But the Defence Department has failed to obtain enough information to judge whether $2 billion in claims were valid, according to the government accountability office. Their 2008 report found evidence of double billing or repayment for unrelated or nonexistent efforts, including $200 million for radar upgrades—even though militants have no air force that would require such radar. Former president Pervez Musharraf later confirmed suspicions that aid had been diverted to defend against India. 'Whoever wishes to be angry, let them be angry,' he said in 2009. 'The Americans should know . . . that we won't compromise our security, and will use the equipment everywhere.' The US has gotten tougher on reimbursements, rejecting 44 per cent in 2009, compared with 1.6 per cent in 2005, according to The Wall Street Journal. 'Reimbursement claims are reviewed carefully and decisions are based on a combination of agreed formulas,' says a US official in Islamabad, via e-mail. 'However, we do not control what the government of Pakistan does with reimbursement funds that go into the state bank.'

3. Didn't the US Boost Funds to Civilian Aid Recently?

In 2010, the US committed to providing $1.5 billion annually for five years in civilian aid. But only $285 million of this Kerry-Lugar-Berman Act money has been spent so far, according to the US embassy. Sen. Richard Lugar (R) of Indiana, a cosponsor, chalked it up to difficulties determining which projects to fund and how to account for them. The sluggishness is partly due to reforms at USAID, says Ms Fair. After years of complaints that development dollars wound up enriching US companies, the agency moved to channel funds through the Pakistani government and small nongovernmental organizations. 'When we moved away from institutional contractors to small NGOs, we are basically moving into an unknown,' says Fair. The US embassy provided a breakdown of how Kerry-Lugar-Berman Act money has been spent. It includes $32.16 million for two dam projects, $54.8 million on flood relief and recovery, $39 million for students to study in the US, $45 million for higher education, $75 million for income support to poor Pakistanis, and $10.34 million for small infrastructure projects. Such figures are not readily available on the website and take some time for USAID to produce, frustrating those tracking the projects. The lack of transparency worries Pakistanis who often distrust NGOs, says Fair. Previous efforts by the Monitor to observe USAID projects in Pakistan have been met with ambivalence. The agency says it wants to show how the US is helping Pakistan, but it worries about drawing militant attention. During hearings earlier this month, Sen. John Kerry (D) of Massachusetts said: 'We have raised this issue forcefully . . . there needs to be a much more effective communications strategy.'

4. What US Goals has the Money Accomplished?

Military aid to Pakistan is aimed at cooperation in the war on terror. Since 2001, Pakistan has launched offensives against Islamic militant havens. Pakistani intelligence has helped the US nab some top Al-Qaeda leaders. Islamabad has also risked popular discontent by allowing the US to base drones and more CIA operatives on its soil. Yet, the help dries up when it comes to targeting groups most active in fighting the US in Afghanistan. Insurgencies are hard to defeat when they have sanctuary across a border. Meanwhile, Pew finds just 11 per cent of Pakistanis have a favourable view of the US, up one point from 2002. 'In the past decade, we've seen $14 billion military aid come in, but has militancy changed? If anything, it has become more acute,' says Aasim Sajjad Akhtar, a political economy professor at Quaid-i-Azam University in Islamabad

5. What if the US Cut Aid?

US lawmakers have said the most likely targets for cuts would be civilian, not military, aid. Cutting civilian aid would have only a 0.14 per cent impact on Pakistan's GDP growth, calculates Shahid Javed Burki, a former World Bank vice president. But the real concern for Pakistan's solvency would be loss of support from international lenders like the World Bank and International Monetary Fund (IMF). 'If the US pulls out of the relationship, the IMF and World Bank look to the US before deciding, and private investors will take a huge hit,' says Moeed Yusuf, South Asia adviser at the US Institute of Peace in Washington. 'Pakistan won't fail if aid disappears. But for a country in trouble, do you really want to isolate it?' In 2008, the economy took a nosedive and the IMF kept it afloat with loans. Pakistan's former representative to the IMF Board, Ehtisham Ahmad, said recently that the IMF was going to deny the bailout request until a last-minute intervention by the White House. (The IMF in Pakistan declined to comment.) 'As long as the multilateral aid continues, it won't impact Pakistan's economy,' says Sartaj Aziz, a former finance minister. A US official in Islamabad argues that yanking civilian aid would undermine the US message of a long-term commitment to Pakistan. It would also affect the civilian government's ability to provide services, further undermining its legitimacy. Rescinding military aid would involve a larger chunk of money, deepening the economic impact to the country. It would also lead to a cancellation of Pakistani military help along the Afghan border. 'Pakistan would say we are pulling out our troops. Handle this border yourself, but don't violate the border,' says Imtiaz Gul, a strategic analyst in Islamabad. 'I would only hope that better sense would prevail.'

Source: Arnoldy, Ben and Issam Ahmed, 'US aid in Pakistan: Where's the money going?' *The Christian Science Monitor*, 18 May 2011, http://www.csmonitor.com/World/Asia-South-Central/2011/0518/US-aid-in-Pakistan-Where-s-the-money-going/How-much-US-money-is-in-Pakistan.

corruption in Pakistani institutions, and that some of the funds meant for military activities related to the War on Terror have been diverted by the Pakistani military for more conventional weapons. Nor is this all.

A large number of documents, some leaked, others obtained by journalists, suggest that there is a great deal of deceit in the US-Pakistan military relationship, and that the Pakistani military is, in fact, undermining the US's campaign and that the Pakistan's military has its 'own agenda'. Recent reports in the US press have revealed that the military is 'playing both sides', and the ISI has been protecting Taliban leaders within Pakistan. Nicholas Kristoff writes that 'the United States has provided $18 billion to Pakistan in aid since 9/11, yet Pakistan's government shelters the Afghan Taliban as it kills American soldiers and drains the American Treasury'.[34] A former US ambassador to Afghanistan argued that 'the United States should demand that Pakistan shut down all sanctuaries and military support programs for insurgents or else we will carry out operations against those insurgent havens, with or without Pakistani consent'.[35] One can only imagine the consequences of such a serious step. Recent revelations by WikiLeaks only reaffirm what has been known in private circles, such as, that there are 'deep clashes over strategic goals on issues like Pakistan's support for the Afghan Taliban and tolerance of Al-Qaeda', and that there is 'frustration at American inability to persuade the Pakistan Army and intelligence agency to stop supporting the Afghan Taliban and other militants', something that is conveyed to Pakistani officials by US diplomats.[36]

Yet another consequence of US aid to Pakistan in the last decade, has been that it, perhaps inadvertently strengthens the hand of the military in comparison to Pakistan's fledgling, emerging, democracy. While even Pakistani academics and scholars, and not just State Department officials, recognize that the Pakistan Army is the most powerful and strongest institution in Pakistan, there is concern that US aid to Pakistan's military (even if this is primarily meant to benefit the US), given the weak civilian set-up, only strengthens Pakistan's military establishment which, as we argue, has benefitted in terms of hardware and financial resources over the last decade, receiving a disproportionate amount of the assistance—see Box 25.3.

25.5 The Nature of Recent US Aid to Pakistan

Since 2008 or 2009, there has been a rethinking in the nature, pattern, form and amount of US assistance to Pakistan. The first major step has been the promulgation of the *Enhanced Partnership with Pakistan Act of 2009*, which committed $7.5 billion in non-military aid to Pakistan over a five year period, spending mainly on social programmes in education, health care, infrastructure development, poverty alleviation, and the like. However, not only is it not clear when and how the Act will actually start delivering aid to Pakistan given numerous procedures and processes, the fact that there was a great deal of disagreement amongst the Pakistani elite, and especially the Pakistani military, when the Act was better known as the Kerry-Lugar Bill, shows that one could expect further debate and disagreement once it becomes fully operational. Moreover, if FATA is an area which is expected to receive special economic and developmental assistance in the form

Box 25.3

Does Aid Really Work? Evidence from Pakistan

Pakistan has received over $100 billion in aid over the last fifty years, and although there are some large projects which show that the money was spent to benefit the people of Pakistan, there have been many programmes and projects which have encouraged waste and corruption. In recent years, one of the biggest aid failures was the Social Action Programme of the 1990s, which revealed that not all aid resulted in welfare and benefits for the people it was intended for. Nancy Birdsall and her colleagues analyse one of the more famous of Pakistan's failed aid experiments.

Repeating a Failed Experiment?

During the 1990s, the World Bank and several donor partners provided a surge in external aid to support Pakistan's social sectors. By most measures, the program failed. Despite millions of dollars of outside aid to support antipoverty programs, poverty was *higher* in Pakistan in 2004 than it was a decade earlier when the program began. Nearly a decade after the completion of the World Bank's program, donors in Pakistan—including the United States, the World Bank, and the Asian Development Bank—are again poised to invest billions of dollars in development assistance in Pakistan. Will they repeat the same mistakes?

In 2005, along with CGD researchers Milan Vaishnav and Adeel Malik, one of us prepared an analysis of the World Bank's social-sector lending in Pakistan from 1990 to 2003. The study reports in painstaking detail the problems of the World Bank and other donors in the 1990s working with the government on health and education in Pakistan. The lessons from this massive donor experiment in the 1990s are even more relevant today, as the United States and other multilateral partners prepare to increase their assistance to Pakistan to historic levels. Today Pakistan is increasingly viewed by US policymakers as one of the most critical—if not *the* most critical—fronts in the US-led efforts to combat extremism. Explaining that the United States cannot secure its interests in Pakistan with bombs and bullets alone, President Obama pointed to economic development as a central component of the United States' security strategy in Pakistan, and Congress authorized a tripling of foreign assistance to Pakistan over

the next five years to $7.5 billion. Ambassador Holbrooke has called for even *more* assistance to Pakistan.

Will tripling (or even quadrupling) US aid money to Pakistan work? What lessons can the United States learn from past donor experiences in Pakistan? As the Birdsall et al. 2005 analysis illustrates, the challenges of effectively spending massive amounts of aid in Pakistan are immense. Despite huge inflows of assistance from donors and multilateral creditors, Pakistan has made little if any progress on the fundamentals of social development, state-building, growing the middle class, and reducing poverty. Its democracy is fragile, corruption and patronage are rampant in government, most of its children never complete primary school, and its health indicators lag far behind those of Bangladesh despite its higher average income. As of 2006, the proportion of people living under the poverty line in Pakistan was nearly 23 per cent.

As US policymakers plan for spending vast new aid resources in Pakistan, they would be wise to consider several important lessons from recent donor experience there.

The World Bank's $450 Million Experiment

In the early 1990s, the World Bank launched an ambitious, multiyear initiative in Pakistan called the Social Action Program (SAP). Between 1992 and 2002, SAP aimed to address Pakistan's chronic underachievement in its social sectors. The program set out to improve the *quality*, *efficiency* and *coverage* of basic services like primary health, education, family planning, and rural water supply and sanitation. The World Bank, in collaboration with several other donors, disbursed $450 million over ten years. The idea was to provide sufficiently large support to provoke greater spending by the Government of Pakistan and to ensure leverage for key reforms, including reduced patronage and corruption.

The scale of the program was impressive. It spanned some 27 different sub-programs, four sectors, all four provinces, and the tribal belt. By almost all counts, however, the Social Action Program failed. Despite the enormous investment of donor resources, Pakistan's human development statistics showed little, if any, improvement. In the decade SAP was implemented, Pakistan's social indicators stagnated, improved only marginally, or—in some cases—even deteriorated. For instance, despite SAP's investments in the education sector, school-enrolment rates stagnated in the 1990s. Alarmingly, enrolment for boys and children in public schools actually declined. While SAP did result in some expansion of physical facilities, the extent to which this construction led to better health and educational attainment for Pakistani is unclear.

More disheartening still, despite the World Bank's perceived leverage, SAP failed in its express mission to increase the Government of Pakistan's financial investment in the social sector. When the program began, the government of Pakistan's contribution to SAP was 1.6 per cent of GDP; by 2000–2001, the government's contribution was 1.4 per cent of GDP, compared to a target of 1.9 per cent.

What Went Wrong?

Compared to more conventional donor projects, SAP's unique program design of directly financing Pakistan's public-sector spending left the World Bank much more exposed to the risks associated with Pakistan's broader governance challenges: elite capture, governance failures, endemic corruption, lack of accountability, weak public institutions, and a lack of a timely outcome monitoring system. This author's report brings these problems to light: 'The implementation failures were rampant—manifested in no-merit recruitment of staff, absenteeism of teachers and doctors, and frequent transfers of staff.' Critical gaps in leadership and continuity of leadership were also major challenges. For instance, the report cited that over a nine-year period, Balochistan had 13 different Secretaries of Education and the Government of Punjab had 14 different Secretaries of Public Health Engineering. The impact of these governance challenges was devastating to SAP's effectiveness.

'Injecting vast amounts of money into a dysfunctional system was unlikely to be successful. . . . Under circumstances of elite capture and misgovernance, more money may not necessarily buy social development. . . . The SAP . . . is an example of how easily social sector interventions can be hijacked by governance failures.'

The World Bank's internal post-completion report on the program pointed out several other design and implementation flaws. During SAP's implementation, World Bank staff noted these challenges. In numerous staff reports and emails, they highlighted the tension between working with the Government of Pakistan to address the chronic, long-term implementation bottlenecks and, on the other hand, the need to disburse a large amount of money quickly. In the case of SAP, the donor bias towards disbursing (the next period will be better!) was paramount. As a result, donor resources continued to flow despite disappointing performance.

'In the absence of clear rules for whether and how to stop disbursements (and perhaps fearing accusations of a lack of consistency across provinces), there was little they (donors) could do beyond highlighting and haranguing.'

Poverty Reduction and Economic Policy

Moreover, the Bank's broader objectives of sustainable growth and poverty reduction were hijacked by SAP. In particular, poverty reduction boiled down to spending more on social programs. There was no serious dialogue on more fundamental economy-wide constraints: including fiscal and debt problems, political resistance to the critical imperative of changing the tax regime, and the abuse of the financial system. The SAP also largely ignored power relations in rural areas, where a quasi-feudal system dominated by a powerful landlord class perpetuates resistance to reform. Even short of encouraging greatly needed land reform, SAP missed opportunities to empower women and the poor in access to services, including small loans, agricultural extension, and legal aid for enforcement of rights to irrigation water.

New Lending Approaches

In the wake of SAP's failures, the Bank turned to new lending approaches that have achieved greater success than SAP program. In 1999 the World Bank launched the Pakistan Poverty Alleviation Fund (PPAF), which enables the World Bank to bypass Pakistan's problematic public sector altogether. The PPAF, now supported by the World Bank and several donor partners, provides more than a billion dollars to more than 80,000 community organizations, which in turn have provided nearly 2 million microcredit loans and grants to rebuild more than 110,000 houses damaged by the 2005 earthquake.

'Support for the PPAF is a reasonable strategy for the Bank,' concluded the evaluation, ' one that goes around the problems of governance that undermined SAP loans, by channelling these funds directly into the hands of local NGOs who can have an impact at the community level.'

In addition to launching PPAF, the Bank introduced a completely new approach to lending for education in Pakistan. Loans go directly to provincial governments and provide direct support to those governments' budgets tied to comprehensive reforms at the system level. This approach has been successful in the province of Punjab. There the program includes a framework of sector-wide educational reforms as well as both supply-side and demand-side interventions aimed at improving school enrolment and quality. The World Bank cited achievements from 2004–2006 of increased budget allocations, a 48 per cent increase in total primary school enrolment, and a decrease in the gender gap in enrolment. In 2009, the World Bank pledged $350 million to support the program for an additional three years.

Lessons for the US Government

1. More aid money does not necessarily buy more (or better) results. Including the Government of Pakistan's own spending, billions of dollars were channelled through SAP. More aid money did not buy more results. In a country plagued by widespread corruption and weak governance and institutional capacity, how donor money is spent in Pakistan is vitally important. The US government would be well-served to find ways to spend money in Pakistan *well,* instead of focusing on emphasizing that they are spending *more,* even if that ultimately means spending less. (See point 3.)

2. **Leverage is elusive.** The United States should be realistic about the extent of its leverage and influence over key economic policy reforms; it has virtually none. One of the lessons of the World Bank's SAP experience is that leverage is elusive, and its limits should be recognized in any strategy to encourage progress against poverty. Recognizing that any leverage that exists will come from joint constructive pressure on the Government of Pakistan, the US government should lean on the main multilateral partners—including the World Bank, IMF, and ADB—to push for policy reforms in Pakistan.

3. **The temptation to disburse must be managed.** Another lesson from the World Bank SAP experience is the dangerous pitfalls associated with pressures to continue disbursing money, even in the face of poor implementation performance. The United States will likely face similar pressures to disburse, given the underlying motivation of the US government to demonstrate their renewed partnership and friendship with Pakistan and their efforts to overcome the trust deficit of the Pakistan public towards the United States.

4. **Channelling aid resources through the Pakistan public sector is risky and is not in itself an effective strategy for improving governance.** The Obama administration has made clear its intention to channel an increasing share of US assistance through the Pakistan public sector and local Pakistani NGOs, and to spend a smaller share of aid on unpopular US contractors. The assistance strategy for Pakistan specifies that this direct assistance through Pakistani institutions is intended to enhance their capacity and to bolster economic and political reform, and build long-term capacity at the sub-national government level.

The World Bank's SAP experience highlights the risk associated with this strategy and casts doubt on this assertion that funding the Pakistan public sector is in itself an effective capacity building exercise. Pakistan is a daunting environment for administering effective aid through the Pakistan public sector. Even a strategy for improving governance and institutional capacity must confront the thorny issues of endemic corruption, local power relations and political economy. Simply directing more money to weak and corrupt institutions will not itself transform Pakistan's public sector governance.

'One can hardly question that Pakistan needs to spend more resources better in its social sectors. But merely raising the expenditure levels is in itself not an assurance that outcomes will improve, particularly in a system characterized by endemic corruption. Indeed, it may be counter-productive, since it may entrench rent-seekers and thus complicate future efforts at reform.'

5. **Expectations should be managed, especially in the short run.** The World Bank's experience in the 1990s reveals a hard fact: it is difficult to spend large volumes of aid money well in Pakistan. Expectations for results, particularly in the short run, should be managed appropriately in both the United States and in Pakistan.

6. **Sustainable poverty reduction and development requires addressing structural problems and political economy issues.** The US government has reiterated its pledge to form a long term partnership with Pakistan and to contribute sustainable development in the country. The SAP illustrated a striking reality in Pakistan that continues to ring true today: successfully and sustainably attacking poverty in Pakistan is simply impossible without addressing the structures of economic and political power.

'Incremental programs—greater access to social services and greater access to microfinance—can help people, but will not make a sustainable difference. A country strategy to reduce poverty has to include politically sensitive economy-wide economic reforms, and focusing on making government, including local government, more accountable to people.'

Source: Birdsall, Nancy and Molly Kinder, 'The US Aid "Surge" to Pakistan: Repeating a Failed Experiment? Lessons for US Policymakers from the World Bank's Social Sector Lending in the 1990s', *Working Paper 205* (Washington DC: Center

for Global Development, 2011), 1–9 www.cgdev.org/content/publications/detail/1423965.

II.

While the excerpt above shows how aid fails, this is not to argue that all aid is a failure. The development of many countries has benefitted by assistance from other countries.

The large field of donors also dilutes the impact of each aid stream. It seems improbable that we will see again the magical combination of large aid flows from a dominant donor—the United States—working hand in glove with like-minded local technocratic elites, as occurred in Taiwan and South Korea some decades ago. This model of domestic political and economic will plus US assistance held steady from the 1950s to the 1970s. The result was a coherent, continuous development effort and rapid growth that galvanized the two countries' economic takeoffs. Development in Taiwan and South Korea also benefited from greater social and political stability than Pakistan is likely to see in coming years. Such stability has been identified as a common thread in diverse exemplars of successful development in widely differing political and economic systems. Foreign aid played a role in many of these success stories—but few countries have faced a combination of internal challenges on the scale of Pakistan's.

Source: Woodrow Wilson International Center for Scholars, also has a study on US aid to Pakistan called, *Aiding Without Abetting: Making US Civilian Assistance to Pakistan Work for Both Sides* (Washington DC: Woodrow Wilson International Center for Scholars, 2011), 20.

of 'reconstruction opportunity zones' and the like, one can be sure that many of the issues which emerged earlier in the decade, will re-emerge.

Along with this civilian aid, a $2 billion military aid package was announced in October 2010, which was meant for Pakistan 'to buy American made arms, ammunitions and accessories' from 2012 to 2016. The United States officials hoped that 'the announcement will reassure Pakistan of Washington's long-term commitments to its military needs and help bolster its anti-insurgent efforts'.[37]

The $1.5 billion five year annual commitment of the *Enhanced Partnership with Pakistan Act of 2009* does make a departure from the earlier (presumably unwritten) strategy which guided US-Pakistan relations since 2001. For example, the Act lists numerous clauses which auger for greater control and accountability of the military. There are clauses which state that Pakistan's military or intelligence agencies have to stop supporting 'extremist and terrorist' groups; that terrorist bases are dismantled; the Act prohibits the use of funds to upgrade or purchase F-16 aircraft, as has happened in the past; there is a requirement to close camps and support to banned Pakistani organizations such as Lashkar-e-Taiba and Jamat-ud-Dawa; Pakistan is expected to play an important role in stopping nuclear proliferation; and, importantly, according to the Act, US assistance will be provided only to a government which has been elected freely, a clause which is meant to work against the attempts to undertake a military coup—see Box 25.4 and Appendix 25.3.

While these clauses need to be welcomed, they raise a particularly problematic question: Why did a civilian, i.e. non-military, assistance package require so many military conditions from a civilian government which was weaker than the military, and often unable to resist demands from the military? If, as most analysts on Pakistan agree, the military and some of its agencies are a law unto themselves, how would imposing conditions on a civilian government ensure that these conditions were adhered to by the military and its agencies?

Box 25.4

Examining US Aid to Pakistan and the KLB

The Woodrow Wilson Center in Washington DC, carried out a study on US aid to Pakistan and how the Kerry-Lugar-Berman Bill would have an impact on Pakistan.

The US-Pakistan relationship, never easy even in the best of times, is in danger of collapsing. The strategic imperatives of the two countries are at odds, while a long history of dashed expectations and mutual distrust makes it difficult to bridge this chasm. Pakistanis resent American infringement of their territorial sovereignty, as exemplified by both the steady drumbeat of drone attacks and the Abbottabad raid that killed Osama bin Laden, and accuse Washington of meddling in Pakistan's domestic affairs. Americans are angry that the insurgents killing US military personnel in Afghanistan all too easily find secure refuge in Pakistan's tribal areas, and think Pakistan ungrateful for the substantial assistance provided Islamabad over the past 10 years.

Unhappiness in both Pakistan and the United States over American civilian assistance to Pakistan is reinforcing other sources of tension. The United States, under the terms of the Enhanced Partnership with Pakistan Act of 2009, has committed to a substantial program of civilian aid to Pakistan over a multiyear period. No policy could hope to satisfy all the conflicting expectations focused on this 'Kerry-Lugar-Berman' (KLB) assistance—but, without meaningful changes to the aid program in the immediate future, both Pakistanis and Americans may find themselves asking, a few years from now,

'Where did $7.5 billion go? Why do we have so little to show for all that money?'

This study sounds a double alarm about US civilian aid for Pakistan, authorized with bipartisan support by Title I of the Enhanced Partnership with Pakistan Act of 2009. Title I calls for *non-security* assistance for Pakistan in support of two interrelated goals: strengthening elected civilian government, and promoting the long-term economic and political development of the Pakistani people. KLB Title I is designed to invest in the future internal stability of an increasingly troubled pivotal state. As the framers of KLB recognized in Title I, a system of accountable civilian government, with input from diverse interests and a progressive business sector, would offer the best chance of producing responsible and capable governance in Pakistan in the long run.

Our first warning bell concerns unintended consequences for *US* interests of punitively reducing or terminating KLB civilian aid to Pakistan, or newly conditioning it on Islamabad's security cooperation. Any of these steps would gravely damage American interests, short- and long-term. As a pressure tactic to bring Pakistan into line with US security policies, threatening to end civilian aid is unlikely to influence policies controlled exclusively by Pakistan's autonomous armed forces and intelligence services. But a punitive cut-off of civilian aid would alienate America's remaining allies in private, media, and nongovernmental organization (NGO) circles. Conditioning US civilian aid on Pakistan's security performance would confirm to sceptical Pakistanis that KLB is, as they fear, just another US lever to press Islamabad to accept US security priorities, and hence an affront to Pakistani sovereignty that is best rejected.

Our second warning bell relates to the relevance and effectiveness of initial KLB civilian assistance programs launched by the United States Agency for International Development (USAID). It is too soon to judge this aid a failure, as some analysts have done, but it is already clear that mid-course corrections are vital to avoid lost opportunities and disappointed expectations on both sides. Some initial obstacles to launching this aid have been beyond USAID control. These include late funding, changing lines of authority, U-turns on how aid should be funnelled into Pakistani hands, and the fractious policy environment in both countries. KLB is burdened with differing expectations on both the American and Pakistani sides and between them. Uncertainties about support for this aid in both countries undercut the very long-term commitment to development that was the point of KLB, making it harder to get Pakistanis to engage. Redressing these problems on the US side will require policymakers to recommit to the original vision—and to convey this recommitment to Pakistanis in a persuasive way.

USAID, however, must acknowledge what many analysts see as a ragged start to its design and delivery of KLB civilian aid for Pakistan. Some Pakistanis see USAID's initial programs as flawed owing to insufficient local input. Critics in both countries see these first choices as scattershot and lacking a cogent underlying strategy linking broad goals to desired outcomes. In addition, many Pakistanis are critical of USAID personnel and procedures in the USAID mission in Islamabad. The rising stakes in Pakistan scream for a bold recalculation of ends and means.

Why? The authors of this report believe that perceptions in Pakistan and the United States about American assistance will help determine whether the overall relationship between the two countries flourishes or flounders. They also believe that the further deterioration of bilateral ties would be harmful to both the United States and Pakistan.

It will ultimately be for *Pakistan* to affirm its equities in placing relations with the United States on a firmer footing and in making foreign aid work better. This study, although involving numerous Pakistani experts, has been prepared under the auspices of an *American* institute of advanced research.

But we can state with great confidence that vital US interests depend on stabilizing Pakistani society, which, in turn, requires strengthening the US assistance program to Pakistan.

What Leads us to this conclusion?

First, writing Pakistan out of the US foreign policy script is not a realistic option. Pakistan will remain important to US interests even after US forces depart Afghanistan. Pakistan's geographic location, demographic heft, military might, nuclear weapons capability, and close ties to China and Saudi Arabia alone will guarantee that. Islamabad is a prominent actor in the Islamic world. A Pakistan well-disposed to the United States could be a key political, diplomatic, economic, and security partner; a hostile Pakistan could throw up major obstacles to achieving US goals.

Second, US vital interests require a successful Pakistan—a more prosperous, stable country, capable of playing a more constructive global role. This would require development of a more robust participatory democracy and more capable civilian institutions, as well as economic reforms and growth sufficient to improve the lives of a burgeoning population.

Third, the list of reasons why Pakistan cannot be ignored is multiplying alarmingly. A perfect storm of internal social, economic, and political crises is bearing down on Pakistan; the storm may dwarf US concerns about terrorism and insurgencies in the 'Af-Pak' area over the next decade. Pakistan's most serious problems have more to do with a selfish elite wedded to a status quo that consigns some 40 per cent of the population to dire poverty with little or no education or health care, than with terrorism or religious fundamentalism. Some astute Pakistanis discern an emerging conflict between powerful haves and disenfranchised have-nots. Chaos in Pakistan would serve no US interest.

The US civilian assistance program to Pakistan, meanwhile, is in grave danger, beset by doubts and suspicions in Pakistan, and scepticism and heightened fiscal pressures in the United States. Some knowledgeable observers have already concluded that KLB has no chance of success. We are not yet prepared to draw that dire conclusion, but we fear that without substantial US changes in the KLB program, it will fail.

Source: Woodrow Wilson International Center for Scholars, also has a study on US aid to Pakistan called, *Aiding Without Abetting: Making US Civilian Assistance to Pakistan Work for Both Sides* (Washington DC: Woodrow Wilson International Center for Scholars, 2011), 4–7.

25.6 Who Benefits from US Aid to Pakistan?

The discussion and evidence above, lead to numerous conclusions, some shrouded in mystery and secrecy, others revealing duplicity, ambiguity and efforts at cross-purposes. Firstly, it is evident that not at all clear to all parties, what the objectives and purpose of US aid to Pakistan are. The US believes that this assistance to Pakistan's military will encourage the Pakistan army to help in the War on Terror in the border regions of Pakistan. There is no real evidence that the Pakistan army is on the same page as the US administration in this regard, and whether the Pakistan government and military feel as strongly about Al-Qaeda and the Afghan Taliban as does the US Administration. If anything, it seems that there is considerable difference of opinion and deception involved in whatever the rules of the game might be.

Secondly, no matter whose war this is—the US's, a global War on Terror, or Pakistan's—no one can deny that the repercussions on Pakistani citizens have been quite catastrophic, resulting in many thousands dead and injured. It is difficult to speculate what would have happened if a particular initiative or policy was taken or not taken; nevertheless, the impact on Pakistan has been severe.

Thirdly, in the past decade, it seems that there has been considerable oversight—perhaps even deliberate—in the aid relationship with Pakistan, and protocols and procedures have been ignored and not respected. Also, it seems that some amount of aid given by the US for specific purposes has been used by Pakistan's military for very different purposes.

Fourthly, since military aid has been twice or three times as large as economic aid, the US might have strengthened the hand of the military in Pakistan's political economy, side-stepping the elected civilian government, at the expense of strengthening and supporting democratic movements and institutions, having greater trust in the ability of Pakistan's military than in the civilian democratic government.

Fifthly, direct US economic aid does not have a critical impact on Pakistan's economy because it is too small, focused on particular areas and regions, and is tied up in issues related to procedures, protocols and contractors. Economic and financial support from the IMF, World Bank and other multilateral agencies has been far more critical to economic stability in Pakistan. However, one must add the important corollary in this regard, that the United States is Pakistan's most important trading partner, by far, and has critical leverage over the economy. Pakistan received 20 per cent of its foreign remittances from the US (around $1.8 billion in 2009/10), 35 per cent of foreign investment to Pakistan comes from the US (around $1 billion), and 18 per cent of Pakistan's exports go to the US ($3.6 billion).

Sixthly, it is not at all clear, 'who benefits from US aid to Pakistan'. There seems to be ambiguity about purpose, and hence 'benefit' is difficult to clarify. While Pakistan's military has helped the US in its campaign—or has allowed the US to conduct interventions such as drone attacks—it is not clear whether this is adequate to win the War on Terror or not. One gets the feeling that this may not be the case. Moreover, it becomes difficult to know what benefits the Pakistan army receives from US military aid meant for the War on Terror. One advantage seems to be, that the military aid clearly earmarked for the War on Terror, has been treated as being fungible by Pakistan's military—probably in full knowledge of the US Administration—to allow the Pakistani military to replenish its wider arsenal. *It is difficult to argue that military aid to Pakistan has made Pakistan safer in any way*, and the results for the US may not be the same for Pakistan.

Seventhly, apparently, there seems to be a large shift since 2009, in the nature of US assistance to Pakistan, with far greater resources allocated to 'civilian' aid rather than military aid. However, the aid may not have been released as yet, and may not have been very visible on the ground in Pakistan. Some conditions imposed in the nature of aid to Pakistan apply some checks and balances on the type of use of resources to check misuse. Only once operational, will one know of the efficacy of such measures. Furthermore, what seems odd, is that a civilian aid package has numerous military conditions, and given the Pakistan government's weak control over and fear about the military, one is not sure how these conditions will be enforced. Moreover, the Pakistan Government will always be able to play the 'moral hazard' card even when conditions are infringed, and it is probable that as long as some of the US's interest are being served, aid will flow despite these conditions.

Leaked documents and cables from Islamabad have also confirmed what was public knowledge, that there is a great deal of 'interference and involvement' in Pakistan's politics by US officials, and the revelations have been 'shocking', 'about how much leverage the Americans were being given by the country's civilian and military leadership to micro-manage domestic politics'.[38] Another report uses stronger language with regard to Pakistan's leadership: 'WikiLeaks precisely proves what was earlier said, i.e. Pakistan has been practically reduced from a sovereign state to an American colony as the president, prime minister, top political leaders and even Army chief all have been shown pleasing or taking into confidence the US ambassador—the de facto viceroy of Pakistan—to continue ruling the roost with the blessings of Washington'.[39] Such commentary and accounts, give a fair idea of the popular and public perception in which the relationship between the US and Pakistan, exists.

What seems to be clear, is that it is the US Administration, especially in its military strategy, which needs the Pakistani military and the civilian government in Pakistan to undertake certain tasks for the US's campaign in the region, *far more than the Pakistanis need the US*. In fact, one could even argue, that Pakistan does not need US aid and assistance at all. Nevertheless, what seems equally clear is that the US Administration has far greater clout and influence over the Pakistan's military and civilian government than its position warrants.[40]

25.7 Summary and Further Reading

25.7.1 Summary

This chapter has examined Pakistan's predicament, and in particular, the issues about aid and war, since 2001. It makes the case that Pakistan has been aid-dependent since its independence in 1947 and often its survival has depended on aid, primarily from the US. The chapter does not examine the role of aid from the World Bank, Asian Development or the IMF, which have all played a substantial role in Pakistan's political economy, as previous chapters have highlighted. US aid to Pakistan has strengthened Pakistan's military at the cost of civilian institutions, and has undermined democracy, as the period soon after 2007 reveals. Moreover, other than being a bribe for Pakistan's elite who benefit from US and other aid, increasingly there is little evidence that aid does any good for the people for whom it is intended. In fact, if anything, the negative consequences of aid seem to far outweigh any possible benefits. If aid to Pakistan were terminated, one could even make the argument that rather than bailing out Pakistan's elite, such a measure would force the Pakistani elite to undertake essential reforms.

25.7.2 Further Reading

For an historic look at US and other aid to Pakistan see: Alavi, Hamza and A. Khusro, 'Pakistan: The Burden of US Aid', in Rhodes, R. I. (ed.), *Imperialism and Underdevelopment: A Reader Monthly* (New York: Review Press, 1971); Brecher, Irving and S. A. Abbas, *Foreign Aid and Industrial Development in Pakistan* (Cambridge: Cambridge University Press, 1972); Ahmed, Feroz, 'Aiding Underdevelopment in Pakistan', *MERIP Reports*, No. 42, November 1975; and Hashmi, Bilal, 'Dragon Seed: Military in the State', in Gardezi, Hassan and Jamil Rashid (eds.), *Pakistan: The Unstable State* (Lahore: Vanguard, 1983).

After 9/11, many think tanks in the US have undertaken research on the nature and implications on US aid to Pakistan, focussing largely on the US's interests rather than what and how this means for Pakistan. The Center for Global Development in Washington DC has produced a number of such reports. See, for example, Birdsall, Nancy, Milan Vaishnav, and Daniel Cutherell, *More Money, More Problems: A 2012 Assessment of the US Approach to Development in Pakistan* (Washington DC: Center for Global Development Report, 2012). www.cgdev.org/content/publications/detail/1426361/; Birdsall, Nancy, Wren Elhai, and Molly Kinder, *Beyond Bullets and Bombs: Fixing the US Approach to Development in Pakistan* (Washington DC: Center for Global Development, 2011). www.cgdev.org/content/publications/detail/1425136/; Birdsall, Nancy, Wren Elhai, and Molly Kinder, 'Beyond Short-Term Thinking: How to Spend Billions Well in Pakistan, for Them and for Us', Center for Global Development Essay (Washington DC: 2011). www.cgdev.org/content/publications/detail/1424399; Birdsall, Nancy and Molly Kinder, 'The US Aid "Surge" to Pakistan: Repeating a Failed Experiment? Lessons for US Policymakers from the World Bank's Social Sector Lending in the 1990s', *Working Paper 205* (Washington DC: Center for Global Development, 2011). www.cgdev.org/content/publications/detail/1423965.

Also see Appendix 25.2 based on by Anjum Altaf's critique of these publications. The Asia Program of the Woodrow Wilson International Center for Scholars also has a study on US aid to Pakistan called, *Aiding Without Abetting: Making US Civilian Assistance to Pakistan Work for Both Sides* (Washington DC: Woodrow Wilson International Center for Scholars, 2011).

Other articles which represent a less biased analysis, include: Anwar, Mumtaz and Kathrina Michaelowa, 'The Political Economy of US Aid to Pakistan', *HWWA Discussion Paper 302* (Hamburg: Hamburg Institute of International Economics, 2004); Ibrahim, Azeem, 'US Aid to Pakistan—US Taxpayers have funded Pakistani Corruption', Belfer Center Discussion Paper # 2009-06 (International Security Program, Harvard Kennedy School, July 2009); Zaidi, S Akbar, 'Who Benefits from US Aid to Pakistan?, *Policy Outlook*, Carnegie Endowment for International Peace(Washington DC: 21 September 2011). http://carnegieendowment.org/2011/09/21/who-benefits-from-u-s-aid-to-pakistan/8kg7. Samia Altaf examines the wider notion and nature of aid use in Pakistan in her *So Much Aid, So Little Development: Stories from Pakistan* (Baltimore: Johns Hopkins University Press, 2011).

Appendix 25.1

Aid to Pakistan: A US Perspective

Nancy Bidsall and her colleagues from the Center for Global Development in Washington DC, undertook a number of studies examining the reasons, intentions, outcomes and the suspicions around US aid to Pakistan. We present some excerpts from their two main reports of 2011 and 2012.

I.

The US-Pakistan relationship is without a doubt one of the most complex bilateral relationships in the world . . . this uneasy alliance. . . . [iii]

Intrigued and more than a little alarmed by the way American development policy had become entangled with diplomacy and defence policies in Pakistan. . . . [iii]

. . . grappling with the thorny decisions of how to secure American interests in Pakistan and spend taxpayer resources most effectively. The US-Pakistan relationship will remain critically important for decades, and there will be other Pakistans. [iii-iv]

Pakistan's development and prosperity matter to the United States. Instability in Pakistan is both an immediate and long-term threat to Americans' security. [1]

It is in the interest of the United States to minimize the risk that the nuclear armed Pakistani state will fail. Weak political institutions, lacklustre growth, poor education and job opportunities for a huge and growing youth population, and a profound sense of injustice among the Pakistani people put at risk the legitimacy of the democratic government and undermine its ability to combat extremism and terrorism. At the same time, Pakistan is not Yemen or Somalia; from a development perspective, it is not Afghanistan either. Pakistan has a large middle class, an active and engaged civil society, a free press, and a fledgling civilian government that is making some progress strengthening democratic institutions. The US interest in Pakistan justifies a reasonable effort to help that country exploit its economic and social assets to build a capable, democratic state. [1]

We recognize that if Pakistan were an equally poor but less strategically important country, far less aid and attention would be devoted to supporting its development. Aid is not easy to do well in Pakistan, and done badly it could be counterproductive . . . because Pakistan's future prosperity and stability matter for Americans' own security. To withdraw aid now has its own cost; it would undermine in many Pakistanis' eyes the legitimacy of their fragile democratic system, and it would deepen their sense that America's single motive for any kind of assistance or engagement is to forestall its own immediate security risks. America can and should be more far-sighted. [3]

Two years later [after the Kerry-Luger Berman bill], the US development program in Pakistan is not yet on course. There has been little serious attention paid to the potential for US trade and investment policy to spur growth and create jobs in Pakistan. Meanwhile, the aid program has not yet delivered. Observers in Pakistan and in Washington identify the same set of weaknesses in its design and implementation. No one is sure what the United States is trying to accomplish in the development space. Because of a debilitating lack of transparency in the aid program, no one is even sure what the United States is doing. With an approach to foreign policy in Washington that emphasizes integrating development and diplomacy, lines of authority over planning and implementing development policy are blurred. Long-term and short-term objectives compete for the same resources, and suspicion abounds in Pakistan that the United States' aid spending is driven more by security concerns and objectives than by development best practice. On the ground in Pakistan, an aid mission already asked to instantly scale up its operations is hampered by shifting (and often conflicting) instructions from Washington and by burdensome oversight and bureaucracy that limit flexibility, innovation, and risk taking. [4]

Fundamentally, as American leaders have recognized, the key to securing US interests in Pakistan is to address not only physical security but also Pakistan's political and economic weaknesses. Indeed, these three dimensions of insecurity—military, political, and economic—are mutually reinforcing in Pakistan, each feeding the others in a destructive cycle. [6]

First, Pakistan's development challenge demands a great deal of humility from the United States and other supporters. Since 1960, all OECD and multilateral creditors have given an inflation-adjusted total of over $100 billion in development assistance to Pakistan. That money has built dams, roads, and schools, has trained teachers, farmers, and nurses, but it has failed to secure the fundamental economic and political reforms that would foster self-sustaining progress. The lesson is about lack of leverage: aid has not and will not buy the United States or other outside supporters the ability to dictate the outcomes of Pakistan's political process. In the case of the US aid program, the $1.5 billion per year in pledged assistance is not an unprecedented aid investment in Pakistan—two multilateral donors have current programs that are larger. It is not a large sum when compared to the size of Pakistan's economy or its population, translating to roughly $8 per Pakistani per year. In 2010, it would have constituted approximately 5 per cent of total federal expenditures. And it is far less than the estimated $11 billion that Pakistanis will send home from abroad as remittances this fiscal year. [9]

Second, the United States must give its development strategy a clear mission. The United States faces many competing pressures and urgent priorities in Pakistan. It is tempting for policymakers to look to the development strategy to pursue additional US strategic objectives, often unrelated to the fundamental goal of state building and economic development. Some would like, for example, for the development program to improve the public image of the United States in Pakistan or for it to secure the Pakistani government's support for US military policies. These additional layers of objectives muddle the development mission, imperil the effectiveness of the aid dollars, and often result in the United States trying to do too much, too quickly, with little enduring impact. Some of these objectives, including the goal of winning 'hearts and minds', are beyond what is possible to achieve with a development program alone. We argue that the United States has to make choices about the primary goals of its policies. [10]

There are at least three ways 'Af-Pak' integration has undermined the development mission. First, in policy discussions in Washington, security and Afghanistan dominate. In cases where portfolios span the border between Afghanistan and Pakistan, the larger budgets and public attention paid to Afghanistan translate into greater amounts of staff time and high-level attention dedicated to that country—at times at the expense of attention to Pakistan. When Pakistan is addressed, security dominates. Trade, investment, and aid lose out.

Second, the integration of development, diplomacy, and defence has muddled the development mission and left the program without a clear, focused mandate. The Kerry-Lugar legislation lists no fewer than 11 different objectives of US policy, including enhancing short-term stability, countering extremism, and improving the standing of the United States among Pakistanis. Non-aid tools are often overlooked, and aid decisions are politicized and subject to short-term pressures. Overall, the program ends up trying to do too much, too quickly. Integration has made long-term development issues in Pakistan more susceptible to distraction by the security and diplomatic emergencies of the moment. For instance, in the aftermath of the Raymond Davis incident in Lahore, the US government cancelled plans for a trilateral economic summit, and the press reported widespread rumours that a congressional delegation visiting Pakistan threatened to cut US aid. [12]

A key motivation of the Enhanced Partnership legislation was to improve the relationship between the United States and the government and people of Pakistan and to reduce widespread mistrust and anti-American sentiment among Pakistani citizens. The bill's authors explained that through the program the United States 'can materially and powerfully demonstrate the true friendship of the American people for the Pakistani people'. Two years later, however, anti-American sentiment in Pakistan has only worsened. [13]

We doubt that the positive effects on public opinion of a well-executed development program will ever outweigh the negative effects of the drone campaign and high-profile diplomatic disputes like those surrounding the Raymond Davis incident and the killing of Osama bin Laden. This is neither the point nor the potential of development assistance. However, whatever possible public diplomacy benefit could come from the program has been stymied by confusion about what it is trying to achieve and a mystifying lack of information on what has been done. [13]

Finally, at the most basic level, key audiences in Pakistan and the United States remain troubled and unaware of how much money has been spent and on what. It is not their fault. Even the auditors responsible for tracking aid spending have expressed deep frustration with the lack of data on the outputs of US-funded aid projects in Pakistan. Basic data on how much aid has been disbursed is unavailable online; we obtained it only after several months of persistent requests. [14]

During the administration of George W. Bush, the United States provided large amounts of aid to Pakistan, the vast majority of which was military focused; only about one quarter was allocated for non-military purposes. [17]

Currently, the indicator that draws the most attention in Pakistan and in the United States is how much aid money the United States has spent. For a strategy intended to promote long-term development, this is a terrible metric of success in two respects. It focuses on money, not impact, and on the accomplishments of the United States instead of Pakistan's own progress. The direct US contribution to development in Pakistan will necessarily be relatively minor, but it should catalyze more significant progress by Pakistanis. [23]

We recognize that if Pakistan were an equally poor but less strategically important country, far less aid and attention would be devoted to supporting development there. Aid is not easy to do well in Pakistan, and done badly it could be counterproductive. [30]

Source: Birdsall, Nancy, Wren Elhai, and Molly Kinder, *Beyond Bullets and Bombs: Fixing the US Approach to Development in Pakistan* (Washington DC: Center for Global Development, 2011). www.cgdev.org/content/publications/detail/1425136/;

II.

[T]here is a strong link between long-term security for America and prosperity and democracy in countries such as Pakistan; yet short-term security imperatives should not crowd out the potential for the United States to work with the civilian government and Pakistani people in their effort to consolidate democracy, build a more effective state, and expand economic opportunities over the long haul. [vi]

We conclude that in the three years since Kerry-Lugar Bill's passage the US development approach toward Pakistan has failed to achieve what its creators and administration proponents had hoped it would. This is a function of many factors over which those responsible for the development effort in Pakistan have had little if any control: the depths of Pakistan's development challenges; anti-American sentiment over the drone war and the deep scepticism of Pakistanis at all levels about US aims in their country; the Pakistani government's reform failures; and the high-profile diplomatic incidents that have interrupted bilateral dialogue. All of the above have limited the United States' ability to carry out an effective development program built on a substantial increase in aid and better trade and investment strategies. External constraints aside, internal bureaucratic and political hurdles that afflict US development policy in general have been particularly damaging in Pakistan, where the US development approach has been poorly insulated from larger security and diplomatic pressures, and where the size and timing of the KLB legislation created counterproductive expectations of what could be achieved both in Washington and in Pakistan. It is admirable that despite all the pressures, the aid program has continued; yet it is hard to deny that the effectiveness of the program has been compromised. [xii]

Within the US government, there has never been a shared consensus about the objectives of the civilian assistance program. As a result of confusion over objectives, there is still no identifiable US-government development strategy that is publicly available or that has been developed in partnership with Pakistani stakeholders. In the absence of a clear strategy, the Obama administration and Congress have relied too heavily on aid as an instrument of development cooperation. [xii]

The administration was also moved by the fact that Pakistan represents a genuine security threat to the region, to the United States, and to the world. By now, the myriad concerns are well known: extremist violence, cross-border and domestic terrorism, the possibility of 'loose nukes', and the potential failure of the Pakistani state. On the basis of these significant development and security challenges, the Obama administration determined that it was in the long-term of interests of the US government and the American people to build a new partnership with the government of Pakistan to help counter these pressing challenges. [1]

First, the United States starts off on the wrong foot in Pakistan partly because of its 'superpower' status. This is not a new fact, although this tension has been exacerbated in recent years. As the world's lone superpower currently engaged in a bloody war in neighbouring Afghanistan and directing a program of targeted drone strikes in the tribal areas of Pakistan, the United States government is at a distinct disadvantage in trying to successfully implement development projects in Pakistan. No matter what the stated objective of US civilian assistance is, many Pakistanis are deeply mistrustful about US intentions. Given the fact that the US government has often sent contradictory signals, it is not surprising there is a great deal of misinformation about US policies. Certain segments of the Pakistani populace, not to mention many political elites, believe the United States is operating with malicious intent in Pakistan. As a result, criticizing and refusing to cooperate with the United States can make for good domestic politics in Pakistan: indeed, such political considerations drove the chief minister of Punjab, Pakistan's most populous province, to reject outright US assistance to any provincial government entities in the wake of the controversial May 2011 bin Laden raid. [4–5]

Because of that history, many Pakistanis believe that the US civilian aid program is contingent on Pakistani cooperation with the United States in countering terrorist elements operating within the sovereign boundaries of the Pakistani state and that at any moment (as has been the case in the past) aid could be withdrawn. [6]

It has not helped that Washington legislators have often called for this kind of conditionality; and in Pakistan the civilian government has not made a point of forcefully clarifying to its own legislators and citizens that such calls have not generally led to major legislative reversals. The problem is further compounded by the reality, well understood on all sides, that the size and scope of the US assistance program for Pakistan is motivated by the security risk Pakistan poses to the United States and the rest of the world, and so is widely perceived as a tool to buy compliance. Proponents of this view believe the United States is only interested in pursuing its strategic objectives rather than materially improving the quality of life of Pakistani citizens. Incidents such as the CIA-manufactured fake Hepatitis B vaccination campaign—a ruse intended to collect information on the whereabouts of Osama bin Laden—had the cost of feeding misperceptions about US efforts. [6]

In Washington, on the other hand, there have been repeated calls from members of Congress to place security conditions on US civilian assistance or to cut off civilian aid entirely because of conflicts between the two countries in the security domain. The constant risk—or at least its perception in Pakistan—of cutting or suspending the civilian development program further compounds popular suspicion of America's intentions in Pakistan. [10–11]

Even within the Obama administration, short-term military and intelligence objectives have often trumped long-term objectives of strengthening Pakistan's civilian government, economy, and civil society. For many crucial foreign-policy actors who occupy a seat at key interagency discussions, development spending is still treated more like a bribe than a tool to assist with 'supplementing Pakistan's efforts in building a stable, secure and prosperous Pakistan.'

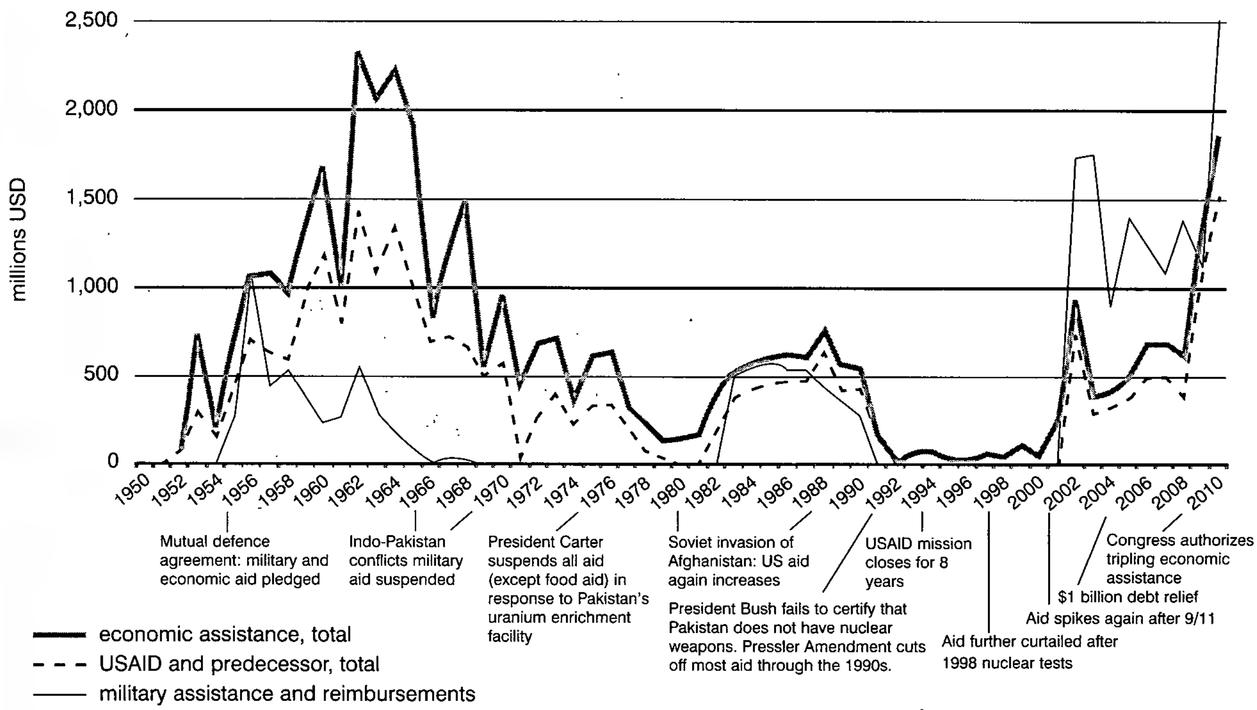
Assuming a better separation between security and development objectives could have been achieved, three years into KLB there is still no consensus within the US government—across executive branch agencies and on Capitol Hill—on the objectives of US civilian assistance. [11]

This difference of opinion is not altogether surprising given that the KLB legislation enumerates 11 different objectives of US civilian assistance. At the heart of the disconnect is a fundamental disagreement between the foreign-policy and development arms of the US government over the objectives of US civilian assistance. The former believes that US assistance must carry out visible, high-impact projects that will improve America's standing in the country. The latter believes that the United States needs to focus primarily on investments in a more accountable and democratic civilian government that better serves the needs of the Pakistani people—investments that may have little visibility and impact in the short run. The former wants an early and visible return; the latter takes the view that though aid may not 'work', the benefits are potentially high relative to the manageable risks. Although some development initiatives may satisfy all of these requirements, most do not. The continued absence of a shared vision has hindered all aspects of US development efforts, from policy formulation to the execution of projects. [11]

This failure to take action that would have measurable impact on Pakistani livelihoods has created deep disappointment in Pakistan and given those who claim that the United States is interested in Pakistan out of a concern for its own short-term security even more ammunition. Over the past year, as we have noted elsewhere, the European Union has taken some small, but important steps to increase access to Pakistani exports. Indeed, the EU decided to reduce tariffs on some 75 products from Pakistan for two to three years as part of their pledge to provide assistance to Pakistan in the wake of the devastating 2010 floods. While this EU action does not go nearly far enough and is only a temporary measure, it is projected to generate between $100 and $300 million per year in additional revenue for Pakistani manufacturers. And the EU spent real political capital to get this done: not only did it have to convince its member states to agree to the plan, it also had to obtain a waiver from the World Trade Organization—which meant convincing the Indians to endorse the plan, or at least not object to it, because the move discriminated against other member states that compete with Pakistan to export the exempted products. [16–18]

Although the United States faces enormous difficulty spending aid money well in Pakistan, we should not ignore the fact that it can have significant influence through policy dialogue. Independent of the size or scope of any aid program, the US government should explicitly commit to maintaining policy engagement at the federal and provincial levels on Pakistan's

Figure 25.1
History of U.S. Assistance and Reimbursements to Pakistan



Sources: For the years 2002–2009, we have added Congressional Research Service estimates of Coalition Support Fund reimbursements, which constituted the bulk of US military assistance, to US Greenbook data. In the absence of Greenbook data for the 2010 fiscal year, we have used budget data compiled by the CRS. Go to www.cgdev.org/content/publications/detail/1425116 for more information

Source: Birdsall, Nancy, Wren Elhai, and Molly Kinder, *Beyond Bullets and Bombs: Fixing the US Approach to Development in Pakistan*, Center for Global Development (Washington DC: CDG, 2011). www.cgdev.org/content/publications/detail/1425136/

Reports and studies from the 1960s suggest, that US aid to Pakistan was critical at times, and helped play a significant part in numerous development projects. Support under the PL-480 (Public Law 480), helped provide the Government of Pakistan food support at critical junctures. USAID was also active in Pakistan in the 1960s and proudly displayed its logo and banner, and it seems, that the US was well-received by the people of Pakistan as an ally and a friend. By 1964, overall aid and assistance to Pakistan was as much as around 5 per cent of its GDP—probably the highest ever in 66 years—and is said to have been critical in giving Pakistan's impetus in industrialization and development in the early 1960s, with GDP growth rates rising to as much as 6 or 7 per cent per annum. In 1965, when the military government in Pakistan started a war with India, the US decided to drastically cut-off all (or much of) aid to Pakistan, and aid resumed, albeit at much lower levels after a few years. Most academics and scholars comparing the pre- and post-1965 war and the impact of aid on development are in agreement, that aid played a crucial role in the high growth rates in the 1960s.[15]

In the 1950s and 1960s, bilateral development assistance from the US to Pakistan was also supplemented by assistance to Pakistan's military, in the form of armaments, training and other resources. While military assistance was terminated in 1965 to be resumed much later, it was the Soviet invasion of Afghanistan in 1979, which ratcheted up US development and military assistance to Pakistan, as Pakistan became a frontline state in the war against Soviet occupation. Large and undisclosed amounts of money and weapons and arms, were channelled through to the mujahidin fighting against the Red Army in Afghanistan, through Pakistan's military and its clandestine agencies, particularly the Inter Service Intelligence (ISI). While this 'aid' was not meant directly for Pakistan's military, there is ample evidence that funds meant for the Afghan mujahideen, were pocketed by members of Pakistan's military.[16] Although Pakistan's army may not have been directly involved in the first Afghan War, it did receive military aid from the US, as did Pakistan's military government, money which was meant largely for the rehabilitation of Afghan refugees and for the development of roads and communication infrastructure built to create quick and easy access to Afghanistan, and perhaps also as 'payback' for Pakistan's role in the Afghan war. However, it is important to add that unlike the positive image of US aid to Pakistan during the 1960s, the image of US aid to Pakistan during the 1980s was far from positive, and once political Islam began to emerge in the region and on the world's map, the US in Pakistan was seen in an unfavourable light in a hostile

environment. The burning of the US Embassy in Islamabad in 1979, and the subsequent covert and overt US role in Afghanistan, helped create a less-than-friendly image of the US in Pakistan, even though it may have been providing large sums of assistance. The popular perception by the Pakistani people of the US as a reliable friend, changed considerably in the 1980s, as did US contributions for developmental assistance.

The Pressler Amendment passed by the US Senate in 1985, severely limited US assistance to Pakistan on account of the latter's covert nuclear programme. As we show above, US development assistance fell from $452 million in 1989, to one per cent of that figure in 1998 due to the sanctions imposed by the US—see Figure 25.1. Even USAID, which had a long history of working in Pakistan, had to close its mission in 1990. The US suspended all economic aid and military sales to Pakistan in August 1990 as part of sanctions imposed in accordance with US laws for pursuing a clandestine nuclear weapons' programme in violation of the international non-proliferation regime. US military and economic assistance to Pakistan in the 1990s, was heavily coloured by the shadows of the Afghan war and, subsequently, by sanctions imposed on Pakistan. It was only after 2001, that a very different US aid relationship to Pakistan, in nature, form and dynamics, has emerged.

25.3 The Complicated Issues of US Aid after 9/11

The first difference from the previous patterns of US aid to Pakistan, is that there is apparently far greater public information about the nature and amount of aid given to Pakistan, as Table 25.2 shows, which allows us to make better-informed judgements.[17] Moreover, for once, we also have clear demarcations between security related (or military) aid and aid granted in the form of economic assistance. As the Table reveals, since 2002 to 2010 (and not including commitments such as the *Enhanced Partnership with Pakistan Act of 2009*), the US gave Pakistan almost $19 billion, or over $2 billion on average each year, with the amount rising over the last three years, with twice as much disbursed/allocated in 2010 ($3.6 billion) compared to 2007. Over the period 2002–08, only ten per cent of this money 'was explicitly for Pakistani development', and as much as '75 per cent of the money was explicitly for military purposes'.[18] This is a particularly important distribution of resources, a point raised and discussed below, although, as Table 25.2 points out, in more recent years, the share of economic-related aid has risen but is still less than half—see also Figure 25.2.

25.3.1 The Purpose of Aid

One would expect, that for the US, the main purpose of providing large amounts of military aid to Pakistan following 9/11, was to assist, in numerous ways, in the war against terrorism focusing on a war against Al-Qaeda, the Taliban, and all forms of terrorism and militancy in the region, in FATA and Waziristan in Pakistan directly, and in Afghanistan, indirectly. The United States considers Pakistan to be an essential ally in the War on Terror since 2001, and as part of its broader strategy, it has asked Pakistan's military to undertake counterterrorism operations in order to meet its objectives. The Coalition Support Fund (CSF) which was created for this purpose, was 'designed to support only the costs of fighting terrorism over and above regular military costs incurred by Pakistan. Nearly two-thirds—60 per cent—of the money that the United States gave Pakistan was part of the CSF'.[19] The Bush Administration requested Congress to appropriate billions of dollars to reimburse Pakistan and other nations for their operational and logistical support of US-led counterterrorism operations. According to Secretary of Defence Gates, 'CSF payments have been used to support approximately nearly 100 Pakistani army operations and help to keep some 100,000 Pakistani troops in the field in northwest Pakistan by paying for food, clothing, and housing. They also compensate Islamabad for coalition usage of Pakistani airfields and seaports'.[20]

It seems then, that the military aid the US is giving Pakistan in the form of the CSF—which has until recently been the largest component of US aid in the last decade—is so that the Pakistani military helps the military objectives of the US campaigns in the region, particularly along the borders of Pakistan. More recently—since 2009—a new category of security-related aid, the Pakistan Counterinsurgency Fund/Counterinsurgency Capability Fund (PCF/PCCF), has also been granted to Pakistan, with the same or similar objectives as the CSF, with perhaps more focus on fighting insurgency within Pakistan, such as the Pakistan military's Swat campaigns in 2009.

As Table 25.2 shows, until 2009, economic-related aid to Pakistan has been negligible, and the primary purpose of aid to Pakistan, has been those issues highlighted above, not economic support, or the building of schools and hospitals, or development, broadly defined. Until 2008, US military assistance to Pakistan since 2001 was $7.89 billion, the large majority of which was CSF money intended as reimbursements for Pakistani assistance in the War on Terror.[21] Thirty per cent of total aid in this period was allocated for economic and development assistance, including food aid. However, in the region where most of the counterterrorism and counterinsurgency activity was taking place in Pakistan, in the Federally Administered Tribal Areas (FATA), as much as $5.8 billion of US aid provided to Pakistan was spent, of which 96 per cent of those funds were directed towards military operations, *and only 1 per cent towards development*.[22]

25.3.2 Has the Purpose of Aid been Achieved?

The US has given Pakistan aid primarily to conduct military manoeuvres which support the US's military strategy in the region. Whether Pakistan's military saw and still sees the same game plan, is a different issue and is further discussed. Nevertheless, one must ask the question, if at all it can be gauged, measured and answered, whether the purpose of this aid has actually been achieved?

long-run economic and social development challenges. The United States has tremendous convening power, and on some specific sectors, it can engage in a useful ongoing dialogue at the technical and political level with Pakistani counterparts. In our view, these sectors include but are not limited to tax policy, trade policy (especially with India and other neighbours), higher education, water, agriculture and energy. Our research reveals that Pakistani government officials appreciate that US expertise in these areas adds real value. [29]

It is now self-evident that the KLB plan of spending $1.5 billion per year on civilian assistance in Pakistan was simply too ambitious, for the United States and for Pakistan. Given the large amounts of unobligated funds for Pakistan, constraints on the aid-delivery machinery, and the acute implementation challenges facing the United States and Pakistan, Congress and the administration should agree on a scaled-back program of development assistance for Pakistan for fiscal year 2013 at least. The United States can adhere to the KLB commitment of spending $7.5 billion on civilian programs, but the time horizon should be extended from 5 to 10 years. One could think of this as a no-cost extension, leaving open the possibility that US efforts will improve, that absorptive capacity in Pakistan will increase, and that there will be fewer bumps (such as Abbottabad) in the road ahead. [30]

Birdsall, Nancy, Milan Vaishnav, and Daniel Cutherell, *More Money, More Problems: A 2012 Assessment of the US Approach to Development in Pakistan* (Washington DC: Center for Global Development Report, 2012. www.cgdev.org/content/publications/detail/1426361/;

Appendix 25.2

What does Aid to Pakistan do?

Anjum Altaf examines the case for aid to Pakistan given its usefulness in the past, examining in particular, the two studies produced by the Center for Global Development, the excerpts from which have been produced in Appendix 25.1.

Aid to Pakistan: Advocacy or Analysis?

By Anjum Altaf

Beyond Bullets and Bombs is the title of the latest report on aid to Pakistan from the Center for Global Development in Washington, DC. In light of the increasingly anti-Pakistan sentiment in the US, the report, addressed to decision and policymakers in Washington, takes on the brief to make the best possible case for the continuation of aid. Hence the subtitle: *Fixing the US Approach to Development in Pakistan*. The report is a revealing illustration of advocacy over analysis; a more open examination would have begun by questioning the impacts of US aid to Pakistan, before deciding if the total benefits of 'fixing' it exceeded the total cost to both sides.

It is to the report's credit that it is forthright and includes all the relevant pieces of information, but the way it uses that information is determined by the choice it makes. What is highlighted or slighted is entirely a function of the case that is to be advocated, and all the evidence in the report could be interpreted quite differently in order to support quite different conclusions.

The point of departure, based on a review of the history of development assistance to Pakistan, is an uncontested matter of fact: 'Since 1960, all OECD and multilateral creditors have given an inflation-adjusted total of over $100 billion in development assistance to Pakistan.' The report goes on to note that there is precious little to show for this assistance, mentions all the problems of the moment, and concludes: 'None of these problems—in the power, education, and water sectors, or on the fiscal front—will be resolved unless Pakistan's political institutions and leaders can tackle them head on.'

It would seem that the obvious question to ask would be, have Pakistan's political institutions and leaders decided, now or ever, to tackle these problems head on? Take illiteracy as an example, half the population being presently illiterate in the country. Has there been strong political or social opposition standing in the way of its elimination? Could it really be claimed that lack of funds has been the obstacle in the way? Are there not countries at the same level of development where illiteracy has been all but removed? Does it really need foreign aid to remove this blight?

The answer is clear, and the question that ought to follow should be equally so. If Pakistan's political institutions and leaders have not accorded any importance to this goal, seen either as a basic human right or a prudent leveraging of its human capital, how is more aid going to change this attitude? The report does not ask the question that it itself posits as central to the effective utilization of aid.

The report lists another lesson from experience: 'No matter what Pakistan's international donors do—or how much aid money they spend—it is Pakistan's own political leaders and citizens who will determine whether their country succeeds.' This is an eminently sensible observation. It follows that in making the case for aid, the report should demonstrate how aid would make Pakistan's political leaders and citizens invested in the success of the country. This dimension is also left unexplored.

Yet another lesson: '[Aid] money has built dams, roads and schools, has trained teachers, farmers and nurses, but it has failed to secure the fundamental economic and political reforms that would foster self-sustaining progress. The lesson is about lack of leverage: aid has not and will not buy the United States or other outside supporters the ability to dictate the outcomes of Pakistan's political process.' The fact that without fundamental reforms much that was done with aid has become undone illustrates well the conundrum. If Pakistan's problems cannot be solved unless its political institutions and leaders tackle them head on, if no amount of money can serve as a substitute for fundamental reforms, and if aid has no impact on the outcomes of the political process, what remains of the case for aid?

This becomes especially important in light of the report's frank acknowledgement of aid's downsides: '[it] can directly fuel corruption and create new flashpoints for conflict' and 'aid spending can, by plugging fiscal and other holes in the short run for Pakistan, make it too easy for Pakistan's own policymakers to put off tough decisions.' Looking at the history of foreign aid since 1960, it is hard not to acknowledge that Pakistani citizens have derived none of the purported benefits but suffered all the real negatives of foreign aid. The report does not address how this is going to change in the future.

Having brushed aside the hard evidence without pursuing its implications, the report builds the case for aid on much less convincing arguments: 'The underlying premise of the United States' renewed focus on economic and political development in Pakistan makes sense. A weak state, lacklustre growth, and a profound sense of injustice among the people of Pakistan put at risk the legitimacy of the democratic government and undermine its ability to combat extremism and terrorism.' True enough, but what exactly is the relationship of the latter with aid?

The report is left with little to clutch except weak straws and ephemeral arguments based more on hopes than verifiable evidence. Three quotes should suffice as examples. First: 'Without exaggerating the importance of US money or diplomatic leverage the United States should focus its development programs to support the many courageous Pakistanis working toward a better future for their own country.'

Second: 'Pakistan's most important resource is its large, highly competent, and well educated middle class that can provide the drive for private-sector growth and policy reform. That group comprises millions of Pakistanis working in the media, academia, public service, and civil society organizations who are dedicated to the idea of a more just and democratic system.'

Third: 'At a less visible level, the United States should support the unglamorous but important projects that maintain the machinery of Pakistan's democracy. Providing, for example, financial and technical support to conduct a technically sound and transparent national census could yield benefits down the road by producing a more representative balance of political power.'

These are desperate arguments. Providing financial and technical support for a census is hardly a credible justification for foreign assistance, nor is the identification and support of courageous Pakistanis a vehicle that can absorb the quantum of aid under discussion. The report is generally lax on exploring the incentive implications of its proposals, but one really has to wonder how it would be any more possible to separate the courageous from the not-so-courageous Pakistanis than it is to separate the real from the not-so-real NGOs that have mushroomed to vie for aid funding.

The assumptions about the middle class themselves remain open to challenge. Quite apart from its characterization as 'well-educated', given the curriculum on which it has been nurtured, it cannot be taken for granted as being so dedicated to a more just and democratic system. It has often been argued, on the basis of the Indian experience, that the middle class is in fact authoritarian in its political preferences, while it is the marginalized majority for whom democracy promises to be the vehicle for upward mobility.

The report glosses over many of the generic failings of aid in Pakistan by conflating them with the developments of the very recent past and the emergence of the Af-Pak paradigm: 'the integration of development, diplomacy, and defence has muddled the development mission and left the program without a clear, focused mandate.' This may have exacerbated the problems, but the report ignores its own reading of the efficacy of aid at least since 1960. Even when there were no such over-riding issues of security, the utilization of aid remained extremely problematic.

In its eagerness to make the case for aid, it could be argued that the report exploits a similar conflation, this time linking trade with aid. These are separate issues with no necessary linkage. The case for trade has been made many times before and can stand on its own. It addresses a different set of imperatives, and more trade will not solve many of the problems to which aid is directed.

Not surprisingly, the report eschews the critical component of any convincing analysis—a counterfactual, which in this case would be the absence of US aid, against which the benefits of the recommendations could be measured. In lieu of a hard analysis, the report merely mentions the following: 'In the case of the US aid program, the $1.5 billion per year in pledged assistance is not an unprecedented aid investment in Pakistan—two multilateral donors have current programs that are larger. It is not a large sum when compared to the size of Pakistan's economy or its population, translating to roughly $8 per Pakistani per year. In 2010, it would have constituted approximately 5 per cent of total federal expenditures. And it is far less than the estimated $11 billion that Pakistanis will send home from abroad as remittances this fiscal year.'

The report then reaches the following conclusion: 'To withdraw aid now has its own cost; it would undermine in many Pakistanis' eyes the legitimacy of their fragile democratic system, and it would deepen their sense that America's single motive for any kind of assistance or engagement is to forestall its own immediate security risks.'

This can hardly be taken as a convincing argument. In the perception of many Pakistanis, the legitimacy of governance in the country, democratic or otherwise, is positively compromised by the dependence on aid and the implications of that dependence. It is no surprise that political leaders themselves have felt it necessary in recent days to take a position against bilateral aid. Pakistanis also do not subscribe to the presumed absence of linkage between aid and the outcomes of the political process in the country. After WikiLeaks, there remains little doubt that political outcomes can indeed be dictated with or without development assistance.

Both home remittances and foreign direct investment into Pakistan would be much larger if citizens and investors had as much faith in the capabilities of Pakistani governments as articulated by the report. The fact that this is not the case takes one back to the critical importance of the observation in the report that it is Pakistan's political leaders who have to address these issues. It has to be admitted that they have not made any effort to do so and the report does not posit any reason to expect a change.

Could it be they feel no need to do so because they believe the aid lifeline will never be turned off, a belief that is strengthened by the type of report under discussion? The report is conscious of this downside and struggles with its implications. After all its arguments, it cannot quite recommend business as usual. Instead, it acknowledges the danger and proposes a half-way solution:

'By funding Band-Aid fixes that delay outright crisis and make it easier to avoid necessary but difficult solutions, even well-implemented aid can delay enduring solutions to Pakistan's most serious problems. To the extent that Pakistani leaders expect and assume disbursement of aid, it makes sense for them to push for that money rather than to work with their political rivals to move on key reforms. For these reasons we recommend that much of the $7.5 billion Kerry-Lugar-Berman aid package not be disbursed immediately. Especially in sectors where serious flaws in public administration are the binding constraints to success, it would be better to backload the bulk of this extraordinary aid investment, to wait until critical policy questions are resolved.'

The report states: '[W]e believe that the pure act of delaying disbursement in certain sectors will benefit both the Pakistani reform process and the ultimate effectiveness of US aid.' As one mechanism, it suggests 'the administration could work with Congress to build a fund (at the World Bank, for example) to finance long-term development programs in Pakistan only when they can be executed well. The United States would continue to supervise the money and retain decision-making power over how and where to spend the aid resources, but could sequester funding that cannot currently be spent well. In the case of energy, for instance, this would mean waiting for the process of reforms to governance and pricing to run its course.'

This makes sense, but it ignores the moral hazard inherent in the suggestion. As long as Pakistani leaders believe that Pakistan is too big to be allowed to fail, it would be in their interest to create situations that would increase pressure to release the aid and speed up its disbursements. This has happened often enough in the past and it remains to be proven that this does not expose Pakistanis citizens to risks graver than those arising from the actual suspension of aid.

But even here, the report manages to suggest a way around its own recommendation: 'There is also an exception to our general note of caution—we believe that, even in a sector as difficult as energy, the United States could safely proceed with one or two very large, very long-term infrastructure projects without endangering the current opportunity for reform. A megaproject like the long-delayed Diamer-Basha dam will take an estimated seven to ten years to be completed. In that period of time, Pakistani advocates for a better-governed, better-performing energy sector can be afforded the space they need to finally secure the common-sense reforms that have eluded Pakistan for decades.'

This could be read as an argument for continuing assistance while buying another seven to ten years of continuity. What justifies the hope that Pakistani advocates for the elusive common-sense reforms would succeed this time when they cannot even get a competent professional to head the energy program? After all, Diamer-Basha is not the first dam to be built in Pakistan. If reforms could not be secured in the last ten years, what is there to give confidence that they would be secured in the next ten?

It is hard not to conclude that the report wishes to help Pakistan despite Pakistan because '[i]nstability in Pakistan is both an immediate and long-term threat to Americans' security.' It has convinced itself, and desires others to be equally convinced, that this time it would be different. In this, it is of a piece with the new aid-funded strategy for the reform of education that it cites with approval: 'Education Reform in Pakistan: This Time It's Going to Be Different.' We have to take their word for it and soldier on, but Pakistanis have heard this phrase several times before.

An alternative reading of the report would suggest that the problem is not with aid in general, but with governance in Pakistan. It is not aid that needs to be fixed, but the governance of the country. The report makes it quite clear that it is not aid that will do so and acknowledges it may be worsening the problem. Yet it proceeds to make the case for aid. And that is what makes *Beyond Bullets and Bombs* almost beyond belief as well.

Source: http://thesouthasianidea.wordpress.com/2011/06/09/aid-to-pakistan-advocacy-or-analysis/

A Reply from the Centre of Global Development

Given Aid's Track Record in Pakistan, Why Shouldn't the United States Scrap It?

21 June 2011

by Wren Elhai in Aid Effectiveness, Rethinking US Foreign Assistance Economic Development, Pakistan

My colleagues and I have written in this space explaining why we do not think the diplomatic commotion following the killing of Osama bin Laden should lead the United States to cut off economic aid to Pakistan. In so doing, we were speaking mostly to those here in the USA who see Pakistan as an unreliable partner, one 'undeserving' of US taxpayer support.

There's another argument for cutting off aid to Pakistan that goes like this: it's not helping and may even be doing harm. Pakistan's future will not hinge on a few billion dollars in external assistance. It will depend mostly on whether its democratic political system can function well enough to deliver a list of long-delayed economic and social reforms (we could start the list with tax, energy, civil service, land, and local government reforms). While none of these reforms have the sex appeal of a SEAL raid or a squadron of armed robotic planes, they are as important if not more so to long-term American interests. Aid can sometimes be actively harmful to a reform movement—and it has an especially poor track record in Pakistan. This is the argument I want to address now, by defending the case that (done right) aid *can* help.

The most scathing review so far of our recent report Beyond Bullets and Bombs: Fixing the US Approach to Development in Pakistan, comes from Anjum Altaf, a Pakistani academic who represents this viewpoint well. He commends us for observing the poor track record donors have of pushing reform in Pakistan and the potential pitfalls inherent in the aid business. But he all but accuses us of intellectual cowardice for not following up by endorsing a total aid cut-off. Altaf concludes:

'It is not aid that needs to be fixed, but the governance of the country. The report makes it quite clear that it is not aid that will do so and acknowledges it may be worsening the problem. Yet it proceeds to make the case for aid. And that is what makes Beyond Bullets and Bombs almost beyond belief as well.'

The difference in our perspectives seems to boil down to two questions: is Pakistan more likely to solve its fundamental development problems with American engagement and support or without it? And, can aid be given more effectively than it has been given in the past?

Dr Altaf and others (including some of my colleagues here at CGD) are ready to wash their hands of aid to Pakistan altogether. Yes, they say, reform tariffs and create investment policies to help the Pakistani private sector expand. But stop giving aid. It's not helping and trying to change it to be better is futile. Come back maybe when Pakistan has sorted out some of these issues on its own—at which point, it may not even need or want aid.

In contrast, our report describes a set of policies—financing programs where reform is already underway, paying for verified results, delaying disbursement where it seems aid is most likely to blunt pressure building for reform, and supporting upgrades to the democratic process that expand the space available to Pakistanis advocating for change—that could make aid play a net positive role in promoting reform in Pakistan. We suggest that other tools, ranging from sensible trade policy to diplomatic engagement to get stalled political negotiations on certain reforms moving again, must be part of the solution.

Altaf and others suggest that Pakistan would be better off under a counterfactual scenario in which the United States gives no civilian aid to Pakistan. But this approach has been tried before. At several points in Pakistan's history, the United States has turned away from Pakistan, most recently for much of the 1990s. That period exacted a lasting toll on the US-Pakistan relationship and did not spur significant motion on economic reform.

In 2009, the United States decided on a new approach to Pakistan—offering greater support to Pakistan's people and its democratic system, not just its military. Regardless of whether you think a $7.5 billion aid package was a good way to show that support, cutting off economic aid would set the United States' relationship with Pakistan back by a decade. Far from increasing the legitimacy of Pakistan's civilian leaders, it would show that the leadership that matters in Pakistan still sits in General Headquarters in Rawalpindi, not in the democratic federal or provincial governments.

We agree with our critics that aid will be only a small piece of the solution in Pakistan, and there are many other things that matter more. But we believe that aid can help. Done well, aid can be part of a broader strategy of engagement that supports Pakistani efforts to finally take the necessary steps to become a prosperous and secure country over the next decade. That is the way development in Pakistan will support US interests—and the metric by which a US development strategy should be judged

Source: http://thesouthasianidea.wordpress.com/2011/06/25/us-aid-to-pakistan-response-to-cgd/

US Aid to Pakistan: Response to CGD

by Anjum Altaf

My critique of the Center for Global Development's report on US aid to Pakistan has elicited a comment from the authors. I appreciate their willingness to engage in a discussion and reproduce their comment in full before offering my own reactions to explain why I remain unconvinced by their arguments.

[The part repeated by Anjum Altaf from the response above, has been deleted for space reasons].

The first point I wish to make is that the stance on aid ought not to be a function of cowardice or bravery. I had argued in the critique that the logic of the argument in the report did not support the case for the continuation of aid. All the hard evidence pointed to its failure in the past while the arguments for continuation rested mostly on hopes and prayers. It is not obvious why one needs to be brave in the face of such strong evidence?

The authors of the report boil down our differences to two questions the first of which they posit as the following: 'Is Pakistan more likely to solve its fundamental development problems with American engagement and support or without it?' The point I made in the critique was precisely that the authors had not addressed this question analytically which is why I had termed the report advocacy, not analysis. There was no counterfactual showing what was likely to happen in Pakistan without aid from the US. In the absence of such analysis, the authors' claim to the contrary should carry no more weight than a self-serving assertion.

In support of this assertion the authors claim that the alternative of no-aid has been tried before when the US turned away from Pakistan, most recently for much of the 1990s. But in doing so, the authors run afoul of perhaps the strongest recommendation in their report—that development aid should not be tied to security concerns. In all previous cases when aid to Pakistan has been suspended it has been as punishment for some political transgression or the other. The allocation of aid has never been decided on objective criteria related solely to its effectiveness and independent of security objectives. The argument in the critique to suspend aid was partly based on the inability of the report to show with any credibility that aid effectiveness would improve in the future.

The linkage of development aid with political concerns is so ingrained that despite the authors' strong commitment to separation, their clinching argument for not suspending aid is that 'it would show that the leadership that matters in Pakistan still sits in General Headquarters in Rawalpindi, not in the democratic federal or provincial governments.' The case for development aid seems to rest on the fact that General Headquarters is opposed to it while the political leadership is for it and at this time the hand of the latter has to be strengthened. There is no discussion here of whether conditions exist or not for aid to be effective for development purposes.

A further argument for aid seems to be that '[I]n 2009, the United States decided on a new approach to Pakistan—offering greater support to Pakistan's people and its democratic system, not just its military.' This is a decision the US is free to make but that does not render it a sufficient argument. Surely, the US would not want to aid Pakistan's people against their will, which seems to the sentiment at present that could be verified

by a referendum. An argument to the contrary would surely be considered anti-democratic and one of arrogance implying the US knows what is good for the people of Pakistan better than the people themselves.

The second difference in perspective posited by the authors pertains to whether aid can be given more effectively than it has been in the past? Surely it can, but there is nothing in the report that gives comfort that it would be in the conditions prevailing in Pakistan. The authors mention several possible ways of implementing aid better including withholding its release which can be interpreted as a partial suspension. But they undermine their intent by advocating continued aid for one or two major projects in the hope that reforms would be put in place during the implementation. In the critique I had pointed out the incentive implications of offering this huge loophole.

The point at issue is that as far as the Pakistani citizen is concerned the US is faced, rightly or wrongly, with a huge trust deficit regarding its intentions pertaining to aid. This trust deficit is too huge to be repaired on the fly. It needs disengagement and re-engagement on terms that are very transparent to all. This new engagement on development has to be completely independent of security concerns both in fact and in appearance. In the future, aid funds could be available on meeting certain well-defined performance benchmarks much as European countries have to meet for eligibility to the European Union. And concessions could be reimbursed only on satisfactory completion of projects that qualify for assistance. There is need to pay a lot more attention to incentive compatibility in the design of donor assistance to countries like Pakistan where accountability of governments to their own citizens is minimal if not completely missing.

In the interim, while the process of re-engagement on fresh terms is negotiated, the US could signal its good intentions by pooling its funds with those of other donors who are considered more acceptable by the people of Pakistan. This voluntary cessation of direct control in itself could go a long way to repair the trust deficit that stands in the way of a productive and honest relationship between the two countries.

Source: http://thesouthasianidea.wordpress.com/2011/06/25/us-aid-to-pakistan-response-to-cgd/

Hand-waving on Aid: Response to Nancy Birdsall

by Anjum Altaf

I am happy to engage in a debate with the Center for Global Development on US aid to Pakistan. However, for me the issue is not aid to Pakistan or aid in general but the analytical validity of CGD's recent reports. I argued that CGD's 2011 report was advocacy, not analysis and based on a reading of a summary of the 2012 report I concluded it seemed no different.

CGD has responded to my criticism of the latter but has, in what I consider a hand-waving style, ignored my central concern and resorted to diversionary arguments to mount a defence. Here, I aim to show why CGD's case remains a weak one.

CGD's first point is that their report has been criticized both in Pakistan and in Washington and 'perhaps this is a sign we have done something right?' But could it not be equally likely that they have gotten something wrong? This tendency, to assume without further questioning the interpretations or outcomes that favour their position, exemplifies what I consider the principal weakness of their reports.

Their second point is to ask if I have actually read their new report. No, I have not. I made clear in my critique that I was responding to a summary published as an op-ed. A reading of an institution's output cannot be demanded; it has to be earned. I did read CGD's first report and found it very weak. The summary of the second did not suggest a difference sufficient enough to convince me that reading another report by the same authors would be a good use of time.

The third point is to allege that I have not read other related outputs by Nancy Birdsall, the lead author of the two CGD reports. Indeed, I have not but my aim was a critique of a specific op-ed, not of the entire oeuvre of its lead author. The best of authors have a few poor pieces to their names, just as the finest of actors sometimes deliver forgettable performances.

The fourth point is to say that since my 'riposte includes too many points for us to address individually here, so perhaps its best for us to simply and clearly re-state the core messages of our recent report, which we did not have the luxury of summarizing in our recent op-ed.' As far as I am concerned, a repetition of the core messages does not take care of my critique that these core messages rest on a very weak analytical foundation.

The fifth point is to mention that the core messages incorporate some ideas that I had myself suggested in my critique of CGD's 2011 report. This may or may not be true but in either case it misses the point. There are some commonsense ideas that should be part of any sensible strategy of assistance if its benefits can be shown to exceed its costs. But random inclusion of a few credible ideas does not by itself make an analysis credible. This much should be obvious to any academic.

The problem with the CGD outputs remains that they are non-analytical—they aim to build the best case for the predetermined position that US assistance to Pakistan must continue because Pakistan cannot be allowed to 'fail'. Whatever concessions are required to sustain that case are made and whatever favourable assumptions are needed to bolster the proposition are adopted. The resulting arguments are often so tortured as to be beyond belief. The authors conclude that 'the report speaks for itself'. To me, the summary suggests it is a weak report. If the model that supports it, and I am not convinced there is one, were to be submitted to a quality peer-reviewed journal, it is highly unlikely to be accepted. Let that be the test that resolves this disagreement.

Any credible analysis of aid to a country must demonstrate benefits with reference to the no-aid scenario and must take into account the incentives, both good and bad, that are generated by the nature of the assistance. I have made the point elsewhere that 'Pakistan's leaders can mismanage and pillage the economy knowing American policymakers have determined that Pakistan cannot be allowed to fail—which is great for the leaders but terrible for the citizens.' Nothing I have read in the CGD reports or their summaries convinces me that this does not remain the case.

http://thesouthasianidea.wordpress.com/2012/09/21/handwaving-on-aid-response-to-nancy-birdsall/

Appendix 25.3

More Questions About Aid to Pakistan

US Senator John Kerry, who along with two other Senators was responsible for the Kerry-Lugar-Berman Enhanced Partnership with Pakistan Act of 2009, himeslf questions the logic of giving aid to a country like Pakistan where there have been so many failures regarding aid given and utilized

On the eve of billions of dollars of Kerry-Lugar money beginning to flow to the PPP government, Senator John Kerry, Chairman of the Senate Foreign Relations Committee, has raised several red flags, asking critical questions about accountability and almost warning that significant portions may end up in accounts of the corrupt elite.

In a strong indictment of the present system in Pakistan, Senator Kerry has written a long seven-page letter to special US envoy Richard Holbrooke dated 25 May 2010 (a brief part of which was reported a few days later by the Boston Globe). Kerry says: 'The danger is much greater than merely the possibility of a portion of the funds being poorly spent.'

Kerry's letter reveals that more than 50 per cent of the KLB funds would go in 2010 directly to the Government of Pakistan or local partners.

'The potential for misuse is significant enough to raise warning flags about the pace of funnelling funds through institutions without a strong track record of transparent, accountable, and effective money management or significant experience in the successful delivery of projects,' Kerry points out in his letter.

'I am writing with regard to our Pakistan assistance strategy for fiscal year 2010, which totals \$1.458 billion excluding supplement 2010 funding,' Kerry begins, pointing out that during the past weeks, the foreign relations committee staff had engaged in an in-depth review of how money would be spent sector wise in Pakistan.

The News has obtained the full text of Kerry's letter to Holbrooke, which deals in detail with the issue under separate headlines including 'Leverage and Sustainability', 'Transparency', 'Accountability', 'Priorities', 'Visibility' and 'Public Diplomacy'.

Under 'Transparency', Kerry points out that the administration should be as transparent and specific as possible about how US funds will be spent in Pakistan. 'To date, this process is still largely opaque to the broader public, including our Pakistani friends and partners. This lack of transparency can generate suspicion and distrust.'

Today, Kerry writes, the public has little access to detailed planning on how the funds will be spent. This creates confusing and unnecessary speculation in Pakistan.

In a significant proposal, which may be hard to sell in Islamabad, Senator John Kerry has suggested that the Pakistani civil society should be engaged in monitoring the use of funds.

The portion on 'Accountability' raises the most critical points and expresses general fears that the money may not be spent but siphoned off by the corrupt elite. 'Channelling so much of the money through untested institutions so quickly could serve to confirm these suspicions,' he says.

Following is the text of the letter and the observations of the committee:

'The Honourable Richard Holbrooke, Special Representative for Afghanistan and Pakistan, US Department of State:

'Dear Ambassador Holbrooke: I am writing with regard to our Pakistan assistance strategy for fiscal year 2010, which totals \$1.458 billion excluding supplement 2010 funding. Since the passage of the 'Enhanced partnership with Pakistan Act of 2009 (the Act) this fall, the Administration has moved quickly to evaluate areas of need in Pakistan and come up with a multi-year funding strategy. I appreciate how much time and effort has gone into these efforts under Ambassador Robin Raphel's leadership, particularly for the USAID Mission in Islamabad, which has had to dramatically increase its staffing and development assistance in a short period of time.

'During the past weeks, the committee staff has engaged in an in-depth review of how money will be spent sector by sector in Pakistan in fiscal year 2010, the first year for which Kerry-Lugar-Berman funds have been appropriated. I wanted to take this opportunity to share with you some observations that have resulted from these briefings with State and USAID officials and other conversation we have had with Pakistani and American partners. I hope your team in Washington and Islamabad finds this feedback constructive in helping shape our Pakistan assistance strategy for FY 2010 and outlying years.

'Thank you for your continued attention to these important matters. I look forward to our ongoing dialogue on how we can best enhance our partnership with Pakistan.

Sincerely, John F. Kerry

'Senate foreign relations committee observations on civilian assistance funding to Pakistan for FY2010:

(1) Leverage and Sustainability: We understand, given past experiences donors have faced in many countries, that the Administration may have limited ability to induce reform of economic policy and governance in Pakistan. We are realistic about this. At the same time, we want to underscore that the Act was passed by Congress to support Pakistan's long-term development progress, on the grounds that doing so is the best investment in the long-term security of the United States and Pakistan. We encourage the Administration to make maximum use of the significant leverage provided by this Act.

'To achieve long-term progress instead of short-term fixes, we encourage the Administration to think strategically about how we can best encourage policy and institutional reforms across each sector so that Pakistanis see long-term and sustainable benefits as a result of US assistance. We should ensure that US funds serve as a multiplier of Pakistani resources, rather than a disincentive for the Pakistani government to invest in its own budget, especially in areas like health, education, and the provision of basic services. Otherwise, the programmes we fund may not be sustainable for Pakistanis when US funding decreases.

* In the health sector, for instance, where spending in Pakistan is only 0.6 per cent of GDP (one of the lowest figures in South Asia) and where other major donors like the British and Canadians have recently pulled their funding because of the lack of structural reforms, we are investing a significant portion of funds (approximately \$181.4 million in FY2010). While the health ministry recently announced it would increase the health budget

to 5 per cent of GDP over the next five years, it will likely be a challenge to achieve this given the tough economic climate in Pakistan. The infusion of US funds could paradoxically act as a deterrent for the Pakistani government to invest its own funds in this area if it can rely instead on outside donors.

* In the energy sector, we are pleased to see the Administration pay particular attention to the ongoing energy crises Pakistanis face. However, as we engage in this sector, we must avoid past donor mistakes and work alongside major donors who are already active. The Asian Development Bank (ADB) and the World Bank have been working in the energy sector in Pakistan for more than two decades. With a great deal of money, continuity, and coordination, they have been pressuring the Government of Pakistan to make exactly the same institutional and pricing reforms but the same problems persist, decades and hundreds of millions of aid dollars later. We must pay careful attention to sequencing if we have not first tacked these critical policy issues we dramatically decrease the long-term effectiveness of our larger infrastructure investments.

* Going forward, we should examine previous donor efforts to avoid past pitfalls, understand political limits on the ground, and value to existing reform efforts on the ground. We hope the Administration will build on the long-standing leadership and work of the major multilateral partners like ADB and the World Bank to have a coordinated approach that better leverages our collective resources with the Pakistan government. The Pakistani government will also need to take advantage of the domestic energy crisis and calls from its own people for relief to find the political will necessary to resolve the energy crisis if we are to make any real progress.

* In the education sector, the Pakistani government has a goal of raising its annual budgetary allocations to 7 per cent of GDP by 2015, a figure that may not be achievable given economic constraints. When our sizeable contribution in this sector is combined with other donor resources and increases in Pakistani government contributions (we are spending approximately $334.4.66 million in FY2010) State and USAID suggest a target of 4 per cent of GDP by 2015 is feasible. However, even with projected increases in the Pakistani government's spending on education, donors, who now provide about 14 per cent of Pakistan's education budget, would need to pay about 37 per cent by 2014–15 to meet this target, according to USAID figures. While donors may be able to meet this need for the next five years, we must examine what would happen in 2015 if donor funds do not continue at this accelerated rate. What plans are in place to help the Pakistani government transition to a more satiable investment in this sector? Past donor experience in this sector is frankly disappointing. Key lessons from past donor experiences suggest that more money may not buy results in the social sectors, and that as much emphasis need to be placed on spending money well and focusing on key institutional reforms needed to sustain change.

(2) Transparency: We appreciated the December 2009 "Pakistan Assistance Strategy Report" that laid out in concrete terms how Kerry-Lugar-Berman funds would be spent over a five-year time period. We urge the Administration to build on this approach by being more proactive and transparent with the broader public both in the United States and Pakistan—on how funds will be spent annually by providing programme descriptions and plans and sharing commitments and actual disbursements. This transparency has been lacking so far.

Much has been made here and in Pakistan about the impact the Act could have on the bilateral relationship. Yet today, the public has little access to detailed planning on how the funds will be spent. This creates confusing and unnecessary speculation in Pakistan, and limits the potential of the policy community and allies at home. The Administration should be fully transparent about how it will spend funds in Pakistan. Given that Act is the centrepiece of our civilian engagement with Pakistan, without greater transparency, this valuable policy tool could lose much of its impact.

For instance, the Administration could create an easy-to-navigate website that provides detailed planning, objectives, and disbursement information; it could consult with the Pakistani Embassy in Washington on programme plans and announcements and it could engage Pakistani civil society in monitoring the use of funds. This would help demonstrate both the seriousness of purpose the United States brings to this endeavour and our commitment to the Pakistani people.

(3) Accountability: The Administration has adopted a strategy whereby US assistance to Pakistan should go through local Pakistani institutions to the greatest extent possible, in order to build Pakistani capacity and avoid the "Beltway Bandit" approach that characterized US assistance to Iraq and Afghanistan. This is a goal we support, if done right and on an appropriate timeline. On 5 March Senators Kerry and Lugar sent a letter to State and USAID laying out the potential pitfalls if we do not have a sound transition strategy in place.

As stated in the letter, we are concerned that that too much money funnelled too fast to the Pakistani government or local Pakistani groups may jeopardise US funds. For instance, there may be issues of absorptive capacity or inadequate monitoring and oversight.

We understand that over 50 per cent of FY 2010 funds are likely to go directly to the Pakistani government or local Pakistani implementing partners. The Administration has instituted some accountability mechanisms, but their effectiveness is yet to be determined. According to USAID, these include pre-award assessments to determine the strengths/weaknesses of the current financial and managerial systems in place. For any agreement with the Pakistani government, a separate bank account will be established, so that all US government funds can be tracked and accounted for through USAID audits. But the potential for misuse is significant enough to raise warning flags about the pace of funnelling funds through institutions without a strong track-record of transparent, accountable, and effective money-management—or significant experience in the successful delivery of projects.

The danger is much greater than merely the possibility of a portion of the funds being poorly spent. If significant portions of the Kerry-Lugar-Berman funds are, for example, siphoned off to private bank accounts, political support for continued appropriation of the money could evaporate in Washington and Pakistan. Among the Pakistani population, there is already a fear that the funds will merely enrich the corrupt elite. Channelling so much money through untested institutions so quickly could serve to confirm these suspicions. Moving forward, we encourage the Administration to closely coordinate its strategy with major

donors like the ADB and World Bank, who have led many of the accountability, transparency, and anti-corruption initiatives on a range of sectors since they have operated in Pakistan. We can learn from many of their experiences and avoid repeating past mistakes. It also helps us calibrate what is realistic and possible in the context of Pakistan assistance.

(4) Priorities: According to the December 2009 "Pakistan Assistance Strategy Report", the three key objectives of our assistance are to:

* Improve the Pakistani government's capacity to address the country's most critical infrastructure needs;

* Help the Pakistani government address basic needs and provide improved economic opportunities in areas most vulnerable to extremism; and

* Strengthen Pakistan's capacity to pursue economic and political reforms that reinforce stability.

The report correctly identifies the critical priorities as articulated by senior Pakistani government officials. Energy shortages, weak social services, a crippled judiciary, and a host of other economic and political ills continue to weaken the Pakistan state. In translating these priorities into annual funding strategies, we urge the Administration to work closely with the Pakistani government and Pakistani civil society actors so that our annual spend plans actually reflect both what is possible on the ground and what is really needed.

* For instance, more focused attention may be needed on the criminal justice sector and addressing rule of law issues, which is a major source of concern for Pakistanis. For FY 2001, $22 million will be spent on rule of law issues with more than $45 million planned over the next five yeas. We understand USAID is currently doing a study on specific court needs and demand for justice at the grassroots level from which it will design a new rule of law programme. Given how pressing criminal justice reform issues are, we appreciate this is an area that will require considerable partnering with the Pakistani government and civil society actors and a well thought out strategy for reform. We hope this is an area where we can demonstrate some tangible progress to Pakistan.

* We urge the Administration to be very clear on how it is addressing water issues across different sectors, which we understand is a top priority yet not at all defined in the materials the Committee received. Without any details on how water issues are to be, or could be, addressed to promote public health, access to energy, agricultural development and in infrastructure improvements, we are unable to assess the Administration's objectives.

(5) Visibility: As the Administration develops its proposals for high visibility projects such as in the energy sector, we continue to urge USAID and State to consult with Congress and Pakistani stakeholders during the development phase, rather than waiting until key decisions have already been made. As of now, it is still unclear what these projects are and how they will be chosen. A careful balance will need to be struck between high visibility projects that would be costly but of huge symbolic significance (i.e. building a major hydro-electric dam) and low visibility projects in several sectors that might quietly serve more people and have immediate delivery impact (i.e. a large number of micro-hydro or other small-scale power generation plants). Long-term investments in social sectors such as education and health should also not be overlooked in the effort to deliver quick impact, high visibility projects.

(6) Public diplomacy: The Administration needs a clear strategy for how to most effectively manage expectations with regard to the funding. Pakistanis need to better understand the purpose of the aid, how the money is really being spent, which entities are receiving funds, and how progress will be measured. We need to be clear about what our goals are and what is achievable so that we are not seen to over-promise and under-deliver. We understand State has a new communications plan for Pakistan, and we welcome these efforts, which are long overdue. We would like to see a specific communications strategy within this broader plan for how Kerry-Lugar-Berman funds will be spent so that Pakistanis understand our objectives and our commitment to this partnership.'

Responding to Kerry's warnings and apprehensions, Holbrooke's deputy Dan Feldman said a few days later that the State Department would make sure that transparency and accountability is maintained concerning the aid being offered to Islamabad.

'We're always open to ways to operate in a manner that enhances sustainability, transparency, and accountability, as Senator Kerry has called for, and which are already core precepts that we have built into our assistance programmes,' he was quoted as saying.

Source: Sehbai, Shaheen, 'Red Flags Raised by US Senate Foreign Relations Committee', *The News*, Karachi, 12 June 2012.

NOTES

1. Government of Pakistan, *Pakistan Economic Survey 2010–11* (Islamabad: Ministry of Finance, 2011), 219.
2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid. 220.
6. Hafiz A Pasha, 'Economic Cost of "War on Terror"', unpublished mimeo, undated, 14.
7. Ibid.
8. Ibid. 15.
9. Ibid.
10. For data prior to 2002, different sources give conflicting data and it is difficult to say how much of the data is accurate. Moreover, data for non-developmental aid is not readily available. After 9/11 and 2002, data for US aid for Pakistan are more readily verifiable.
11. Mumtaz Anwar and Kathrina Michaelowa, 'The Political Economy of US Aid to Pakistan', HWWA Discussion Paper 302 (Hamburg: Hamburg Institute of International Economics, 2004), 3.
12. Ibid.
13. Ibid.
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15. See Parvez Hasan, *Pakistan's Economy at the Crossroads: Past Policies and Present Imperatives*, (Karachi: Oxford University Press, 1998).
16. See Shuja Nawaz, *Crossed Swords: Pakistan, Its Army, and the Wars Within* (Karachi: Oxford University Press, 2008), and, Hussain Haqqani, *Pakistan: Between Mosque and Military* (Lahore: Vanguard, 2005).
17. While information available in the public sphere is far better than in the past, we still do not know for sure if *all* aid data are made available. My guess is that this is probably not the case.
18. Azeem Ibrahim, 'US Aid to Pakistan—US Taxpayers have funded Pakistani Corruption', Belfer Center Discussion Paper # 2009–06, International Security Program, JFK School of Government, Harvard University, July 2009, 6.
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21. Center for American Progress, 'US Aid to Pakistan by the Numbers', August 2008.
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23. Azeem Ibrahim, op. cit., 8.
24. Ibid., 10. Emphasis added.
25. Ibid. It is not clear if this $9.7 billion in five years was part of the military aid, or as seems probable, *additional* funds made available to Pakistan's military. If this was the case, the publicly available information about US aid is severely under-reported.
26. Ibid. 13.
27. Ibid. 18.
28. Ibid.
29. Ibid. 21.
30. Ibid. 21.
31. Ibid. 22.
32. Ibid. 24.
33. Ibid. 14.
34. Nicholas D. Kristof, 'A Girl, a School and Hope, *New York Times*, 11 November 2010. Numerous investigative reports and articles in the *New York Times*, suggest that this is so. See Maureen Dowd, 'The Great Game Imposter', *New York Times*, 24 November 2010.
35. Zalmay Khalizad, 'Get Tough on Pakistan', *New York Times*, 20 October 2010.
36. Jane Perlez, David E. Sanger and Eric Schmitt, 'Wary Dance with Pakistan in Nuclear World', *New York Times*, 1 December 2010.
37. *New York Times*, 23 October 2010.
38. Baqir Sajjad Syed, 'WikiLeaks Bombs Rock Islamabad', *Dawn*, Karachi, 2 December 2010.
39. Ansar Abbasi, 'After the WikiLeaks Deluge', *The News*, Karachi, 2 December 2010.
40. Parts of this Chapter have been published in different forms in: 'Who Benefits from US Aid to Pakistan?' Carnegie Endowment for International Peace, Policy Outlook, Washington DC, 21 September 2011, and 'Who Benefits from US Aid to Pakistan', *Economic and Political Weekly*, vol. 46, no. 32, 2011.

26 Political Economics: Class, State, Power, and Transition

This chapter reproduces much of Chapter 22 from the Second Edition of *Issues in Pakistan's Economy* published in 2005, although it also makes some changes where necessary. It provides not just a historic evaluation of the issues of class, state, power and transition in Pakistan between the period 1947 and 2005, but also allows us to see the extent of the change that has taken place eight years later, at the end of 2013. It additionally shows us how predictions and assessments are often influenced by the current moment and why, frequently, our assessments are wrong. In 2005, there was a sense of comfort with the way things were in Pakistan for many observers, and General Musharraf ruled Pakistan without much opposition. In fact, one of the main arguments made at that time, reproduced in this chapter, was that the political opposition to Musharraf had been co-opted, as had what was then called 'civil society'. The General was in an advantageous position in 2005 with US President George Bush backing him, and the two main political leaders, Benazir Bhutto and Nawaz Sharif, in exile. The economy was supposedly doing well and numerous members of Pakistan's elite were praising the virtues of having a military dictator in power over an elected government. All that changed in 2007, as Chapter 27 shows, and hence it is recommended that both Chapters 26 and 27 be read together.

Now, as we know, much of the prosperity and stability in 2005, was a charade. In 2007, with the dismissal of the Chief Justice of Pakistan and the military attack on the Lal Masjid in Islamabad in July of the same year, followed by the assassination of Benazir Bhutto in December, the entire political, economic and social edifice of calm, quickly came undone and crumbled. By March 2008, Pakistan had its first fairly elected government since 1971, Musharraf was gone by September 2008, and Pakistan entered a completely different course from the one taken between 1999 and 2008, or between 2001 and 2008. Of course, the government which replaced Musharraf's was influenced by and suffered on account of, the period 2001 to 2008, but Pakistan's political economy, its state, the nature of power and even the nature of transition, changed. This Chapter recounts assessments till 2005, while Chapter 27 deals with 2005 to end 2013. Pakistan's political history also shows how difficult and unwise it is to make predictions, for events do not always follow an expected trajectory. Too many unexpected events have led to as many unintended consequences.

Towards the end of the twentieth century, one saw not just the demise of socialism, as it was then practiced, but also, largely, of military dictatorships in much of the developing world. Unlike in the period from the 1950s to around the mid- and late-1980s, when military and authoritarian, often fascist, governments were the norm, by the 1990s, democratic governments had emerged in almost all of Latin America, Eastern Europe and in Asia. The nature of democratic transition varied in each region and there were also differences in how particular countries within the same region negotiated this transition, but nevertheless, most countries were successfully beginning to remove the obstacles on the road to participatory democracy. Hence, at the turn of the new millennium, democracy had emerged as the new norm and military dictatorships and authoritarian governments had, for the most part, been swept aside by this global wave of democratisation.

At the time of writing—January 2005—there were very few militaries ruling their own countries—there were occupier armies, of course. Sadly, Pakistan was one of those very few countries which was still ruled by its military and where democracy, in any meaningful and workable notion and sense of the term, did not exist. In their quest to move along the democratic transition, while many countries had acquired even just symbols of formal democracy—frequent, free and fair elections; an active and functioning Parliament and Constitution; accountability of elected representatives by the electorate; etc.—and lack any degree of substantive democracy, Pakistan had neither formal nor substantive democracy in any real meaning of the terms.

Pakistan had been ruled by four military governments for thirty-three of its sixty-six years of existence since independence in 1947. In addition, there is ample evidence now, which confirms the earlier suspicion that during the partial democratic interregnum of 1988–99, individuals and institutions of Pakistan's military played a crucial role in the political process by backing and supporting particular individuals and by creating political parties and alliances, and in determining Pakistan's foreign policy, particularly with regard to its neighbours. All three substantial and far-reaching structural reforms with regard to the devolution and decentralization of local administrative units, which as we have shown in earlier chapters have had a profound impact on social and political relations and outcomes, have also been undertaken by the three military governments that have taken over power each time after a period of twenty years, in 1958, 1977 and most recently in 1999. Moreover, the growing economic and corporate interests of the Pakistan army, also made it a key player in decisions regarding investment, trade and distribution, and over the issue of redefining property rights. Without a doubt, Pakistan's military was the most central and most powerful of all its institutions, a fact that

had been re-emphasized repeatedly in recent years within a domestic, regional and global context.

Yet, while it was the most powerful and dominating of all institutions of the state in Pakistan, Pakistan's military contended with numerous other social groups, factions and forces, and worked within spaces created by the interaction with these groups and classes. The fact that the military dominated Pakistan's political, domestic, regional and global scene, was a reflection of the power of the military, as much as it was of the failure of civil society and political institutions which, unlike in other countries that have had authoritarian and military governments in the recent past, have been able to claim their own space with control of the state. Pakistan's failure of state and society, needs to be seen in this more dynamic, more holistic, sense.

Although it has been for many years and certainly was at the time of writing, the most overdeveloped and prominent actor determining Pakistan's social, political and economic transition, this Chapter is not about Pakistan's military, but more importantly, about the nature of social change that has taken place over the last six decades or so. Its purpose is to identify social groups and forces that have had an impact on Pakistan's society, polity and economy, of which perhaps the military as an institution, was the most dominant.

At the end of the last millennium, in the years leading up to the celebration of the fiftieth anniversary of Pakistan's independence, the one word most audible was 'crisis'. And not just one crisis; there were a large number of crises or fault-lines in Pakistan's society, polity and economy. A number of newspaper articles articulated the presence of a crisis of the economy, of governance, of the judiciary, of government, and so on. The general perception amongst the newspaper-reading elite of Pakistan was that Pakistan had lost its way, that Pakistan was a 'failed' state, having failed in so many ways. Even after fifty years, the perception was that Pakistan had not been able to address central issues in its society, and there was the belief that, rather than heading towards progress, the country was unravelling, becoming more like Somalia than South Korea. There was growing 'consensus' that Pakistan's democratic experiment of the 1990s had failed. The coup by General Pervez Musharraf in October 1999 offered some respite to some sections of Pakistani society, who felt that yet another saviour of Pakistan had appeared on the scene. In particular, sections of Pakistan's somewhat westernised and liberal elite, and members of civil society—many of whom have a distaste for popular politics and democracy of the Pakistani guise—were euphoric at the General's intervention to end democracy. This chapter argues that while there are numerous structural problems that exist in the different layers that constitute Pakistan, what we were seeing was a manifestation of the particular form of transition which Pakistan was passing through.

While one purpose of this Chapter is to examine the nature and relationship between different social groups and classes that form Pakistan's state and society, it has many others. A key objective is to interpret many of the economic and other issues discussed and raised in the previous chapters, in terms of politics, i.e. to examine the influence of economic factors on social classes. The difficult attempt is made to assess how the economic process of Pakistan's near six decades has influenced politics, the state, classes and society, and also how all of them have, in turn, affected each other and the economy.

An examination of the different chapters of this book will inform the reader about the massive changes that have taken place in different sectors of the economy over the last sixty-six years. These changes came about due to alliances between different political and economic elites, which have usually been the same group of people, and their relationship to the more permanent institutions of the state. A number of important economic and political turning points over the years had affected the nature of the type of class formation that had taken place in the country, and this in turn has had repercussions for the political settlement and on the nature of politics.[1]

26.1 Civilian Bureaucracy and Industrialization: 1947–58

In the early years, soon after Pakistan came into being, the state was run by a small group of bureaucrats who were essentially responsible for bringing about policies to ensure the survival of the country at a time when the odds were clearly stacked against it. With seven million migrants, a political system that was greatly dependent on that devised by the British to preserve and extend their role as a colonial power, and without much industry to speak of, the first few years were such that the civil service seemed to be the only institution organized and modern enough to run the country. In terms of political entities, there were a large number of big landowners, mostly feudals, and an equal number of sardars and tribal leaders. Since there was no industry, there was no class of individuals related to the industrialization process. Essentially, bureaucrats dominated the political scene in Pakistan for the first few years, with a collection of land owning politicians, nawabs and sardars comprising the core political equation.

Mercantile capitalists soon emerged as an economic group and, after making unprecedented gains from the Korean War bonanza, consolidated their economic position. Many traders who had made money in the early 1950s began to invest their profits in industry, and emerged as the main industrialists of the 1960s. The industrialization process that took place in Pakistan in the middle and late 1950s was ably nursed through by the bureaucracy, who played perhaps the key role in establishing industrial units in the country. State-owned institutions like PICIC and PIDC were fundamental in encouraging the development of industry in key sectors. Moreover, a trade policy that had a formative influence on industry was also actively pursued, so that a particular type of industrialization process could take root. The conventional wisdom at the time, of import substituting industrialization, seems to have been carefully thought through by the institutions of government and bureaucracy, and acted as an impetus to the nature and direction of industrialization.

The first decade after independence, hence, seems to be one where bureaucracy-led and assisted industrialization

took place. The bureaucracy seemed to be the leading unequal partner in any political settlement that existed between the key players, and determined the outcome of policy and its application. Industry was the junior partner in this formation, and other political groups, many of which were nascent at that time, had little role to play in the political economy of the country. While the landlords and nawabs may have had some political clout, clearly economic policy was not focused towards increasing or improving their economic well-being. The growth rates in agriculture, for example, were dismal in the first decade, emphasizing the belief of the bureaucracy that the way to develop was through industrialization, even at the cost of agriculture and the rural areas, where almost 80 per cent of the population lived. Since much of the bureaucracy was composed of urban migrants from India, it had little knowledge of or interest in agriculture, and felt that manufacturing should receive far greater state patronage.

Industrialists, while gaining economic clout through very high profits made in the early years, were never a political force and depended greatly on the benevolence of the licence-raj of the civil servants. Political wrangling between different actors of the landowning class also did not allow those politicians to emerge as a strong and united political force. With disarray in the ranks of the political groups that existed, the military stepped in to restore law and order and to continue and escalate the bureaucratic capitalism that had emerged in the 1950s.

26.2 Civil and Military Bureaucratic Capitalism: 1958–71

The military emerged as the stabilizing shell under which industrialization, with the help of the bureaucracy and the emerging industrialists, could develop further. The very high growth rates in the economy and in large-scale manufacturing would not have been possible without a central command, and the only institution capable of providing that sense of order at the time was the military.

Although there is debate about the reasons for the land reform of 1959, whether it was undertaken to break the hold of the bickering political landowning class, or to provide an impetus to the process of capitalist agricultural development, the consequences of the reform were that both outcomes took place. The hold of the large landowners was indeed dented but, more important, the reforms and the numerous other interventions that took place in the agricultural sector brought about nothing less than a revolution in agricultural production and social relations of production; and this in fact altered the face of Pakistan once and for all. Shahid Javed Burki has argued that, towards the late 1950s, landlords were again emerging on the political horizon, and Ayub Khan's shifting of power from Karachi to Lahore and Rawalpindi resulted in more representation for indigenous and rural Pakistan, which is one reason why agriculture gained prominence throughout the decade.[2]

Industrialization, which began in the late 1950s, was not in itself sufficient to lead to economic growth and development, unless there was a change in the rest of the economy as well. Industrialization required consumers, and consumers could emerge only if there was a class of individuals who had purchasing power in excess of their subsistence wages. With 75–80 per cent of the population in a rural economy where agriculture was the only mainstay, and that too an agriculture with a declining output each year, it is unlikely that the consumer boom of the 1960s, and hence the phenomenal growth in agriculture, could have taken place, unless agriculture had developed and unless rural areas and semi-urban areas had become more than just crop-producing areas. Without an agricultural revolution, the industrial revolution in Pakistan could not have taken place. This symbiosis between industry and agriculture was critical to any development or growth plan for the economy.

If the development of agriculture following the land reform of 1959 was indeed a thought-out process and policy of the military-civil bureaucracy-industrialist nexus, it shows the deep political and economic insight of the main policymakers of the time. If it was a matter of accident, then this is one of the many fortuitous moments in Pakistan's history which have changed its destiny on numerous occasions.

The 1960s witnessed the emergence and consolidation of many political groups and economic classes. In agriculture, the hold of the large landowners may not have been broken, but it was certainly shaken enough to allow other economic categories to emerge. Many of the large landowners had the foresight to read the writing on the wall, and accepted the Green Revolution technology package introduced by the government. Although this was an élite farmer strategy, given the high costs associated with the purchase of tractors, the sinking of tube wells, and other ingredients of the package, state subsidization gave the middle farmers, too, the opportunity to adopt this technology. This was the essence of the Green Revolution: the middle and *kulak* farmers, along with many other farmers at both ends of the spectrum, emerged as capitalist farmers, soon to become a dominant economic and political force, in agriculture and in the country.

In the rural areas, alongside this emerging capitalist farmer we also see the genesis of the small-scale manufacturers, and the skilled and technical workers, the growth of an ancillary service sector in order to service the new economy, and a disenfranchised, landless agricultural wage-labour class. To some extent, the political ambitions of the newly emerging agricultural capitalists were accommodated in the Basic Democracy Scheme of Ayub Khan, but without giving them any real political power. This was perhaps the beginning of the apprenticeship of this class of rural politicians, which was to emerge, especially in the Punjab, in the 1970s and was to stamp its mark on the political economy of the country. The military and civilian bureaucrats under Ayub 'had forged a strong political alliance with a number of middle class urban and rural groups', which helped in fostering economic development and political participation. Moreover, the Basic Democracies[3] system 'not only gave a voice to the middle class peasantry of Punjab and the NWFP, but also converted Pakistan's powerful civil bureaucracy from an apparatus for maintaining law and order into a remarkable vehicle for promoting development'.[4]

On the industrial side, with excessive profits in industry and an industrial class protected by government policies, we see a great consolidation of the economic power of this class. Interestingly, despite emerging excessive wealth, the industrial capitalist class did not emerge as a *political* class in terms of seeking political office. Its relationship was that of a partner with the bureaucracy, through which it sought economic gain and wealth. It did not need to seek political power in a more overt manner, as perhaps the large landlords did, since they had no other sense of identity except the desire to rule the country. While the military governed in the 1960s, it was not involved then in the economic process, as it was to become involved in the period under General Zia ul-Haq.

Hence the political nature of the regime, or the political settlement in the Decade of Development, was one where the military and the bureaucracy governed Pakistan, assisted by allies in the industrial and agricultural sectors. Economic power lay essentially with industrialists, but with the capitalist agriculturists swiftly emerging to stake their claim. Moreover, this period also saw the rise of an aspiring, but small, educated middle class that wanted to impart a vision on the political scene, but which lacked the economic power to do so. In Zulfikar Ali Bhutto, it found a leader on whom it could pin its hopes of fulfilling a social and socialist agenda.

26.3 A Shift in Emphasis: 1971–77

Zulfikar Ali Bhutto emerged from the numerous contradictions of the Decade of Development. His constituency, which varied at different times of his political career, shows how all those social groups and classes which had not been direct beneficiaries in either political or economic terms rallied behind him. Hence, other than the large industrialists, the military, and the bureaucracy, Bhutto at different times reflected the aspirations of all classes.

In the beginning, leading up to the general elections of 1970, and in the first two years of his rule, organized labour, peasants, middle farmers, the urban and rural middle class, and the educated professional urban middle class all supported Bhutto's left-leaning economic policies. The bureaucracy and industrialists were the key 'enemies' of the new social programme of the early 1970s, while the discredited military, although not such a direct target as the other two, was marginalized and sidelined. The large landowning lobby, too, suffered the anger of the establishment, and the 1972 land reforms were meant to break their (dormant though aspiring) political ambitions.

However, the political settlement that emerged in the early years of the Bhutto regime soon changed, and the same classes which had been targeted, regained their prominence. The 1972 land reforms did not really break the hold of the large landowners and were more a showpiece political ploy, despite the avowed political programme of the Pakistan People's Party. Having abused and insulted the 'feudal' landowners, Bhutto brought them back into his fold. The educated, left-leaning, urban middle class was in disfavour in the Bhutto ranks, although Bhutto persisted with much of his social reform agenda. With massive nationalization, the bureaucracy was back in favour and began to consolidate its hold over the means of production. The military, too, found favour when Bhutto had to quell the armed rebellion in Balochistan. Hence, the political groups which had been discredited in the early Bhutto period re-emerged as Bhutto needed their assistance, and they were ready to take revenge for the show trials of the earlier period.

The industrialists, however, were never welcomed back. The nationalization of banks broke the critical link between finance and industrial capital, and much of the capital held by industrialists fled overseas. While this class of industrialist was discriminated against and hounded out, not just from the economy, but also from the country, Bhutto's reforms helped to consolidate the small-scale manufacturing process started by the Green Revolution. Small-scale industry and the informal sector became the backbone of industry, replacing the twenty-two families of Ayub's era. This urban middle class, which consolidated itself under Bhutto, eventually allied itself with other sections of the urban middle class, backed by the bureaucracy and probably the military, and was instrumental in removing Bhutto in 1977. Thus, the beneficiaries of Bhutto's economic programme led the movement to remove him from power, just as the results of Ayub Khan's programme caused his (Ayub's) downfall.

Hence, between 1947 and 1977 the following picture of Pakistan's political economy emerges. Large-scale economic development had taken place, in both urban and rural areas, giving rise to a middle class that was still young and economically prosperous, but was essentially non-existent in political terms. Industrialists, having made great inroads and extraordinary economic gains in the first twenty-five years, were nowhere on the scene, even in economic terms, in 1970; many had lost their fortunes, while others had fled the country. The 'feudals' had increasingly been losing economic power as mechanization took hold in agriculture, and as capitalist agriculture began to dominate production. Those large landowners who could see the changes taking place and were able to adapt managed to survive financially, while others were forced to sell or rent out their land to the aggressive middle farmers. As a political entity, however, especially under a democratic order, the large landowners did control a number of seats, particularly in Sindh, southern Punjab and parts of Balochistan, where tribal lords held power. The civilian and military bureaucrats were the only political grouping which, despite a small period in quarantine, continued their influence on the political structure of the country. The heyday of the civil and military bureaucracy, however, was still to come.

26.4 A Military State and the Middle Classes: 1977–88

The takeover by General Zia ul-Haq crystallized the hegemony of the civil and military bureaucracy, not just on the political map of Pakistan, where they had existed previously, but also, for the first time, in the generation and distribution of economic resources and wealth. With

political and administrative roles and interests, the civil and military bureaucracy emerged as a key and entrenched entity in the economy. It established and consolidated its role in economics and politics throughout the Zia period, going from strength to strength.

Despite the pro-private sector penchant of Zia's regime, much of the industry nationalized under Bhutto was not returned to the original owners because it permitted the bureaucracy to continue to play an important role in the economy. The bureaucracy emerged as a critical ally for Zia, and he had no need to undermine their role by distancing them from key areas of economic control and power. The role of the military also changed compared to when it was first in power under Ayub. Earlier, the military had played primarily an administrative role, but under Zia it became more and more visible in the economic sector as well. Many lucrative positions in the huge public sector were made available to retired and serving military personnel, and it became far easier for private companies to curry favour and make economic progress if they had close ties with members of the military establishment. Military personnel were invited to serve on the boards of companies to assist in negotiating the controls and regulations involved in investment decisions. This networking paid great dividends both for industrialists and the private sector, and for individuals from the military. From the Zia period right up to today, the personal wealth of a very large number of military personnel has grown in a way that could not have originated from their official salaries. Today, many large businesses and enterprises are owned by retired military officials and they have joined the ranks of the industrialists, thanks to the links established under the rule of General Zia.[5]

The windfall gains that resulted from the Soviet invasion of Afghanistan, in the form of substantial aid to the (military) government and to the military directly, was also an important conduit for making personal fortunes. There is extensive evidence of corruption, smuggling, and the emergence of a drug and arms mafia and economy due to the fallout from the Soviet invasion of Afghanistan. It resulted in many civil and military bureaucrats making huge sums of money, even through legitimate channels, as opportunities to amass wealth were widespread. In an economy of defence, with the bogey of Soviet expansionism used to acquire more arms and more aid, military personnel used contracts of different types to further their personal fortunes. Moreover, the armed forces also emerged as a collective economic institution, where the different welfare foundations of the army, navy, and air force became more involved in economic activities and even in direct economic production. In economic terms and by amassing huge fortunes, the military was a major beneficiary of the rule of General Zia ul-Haq. The image of soldiers fighting to defend the motherland changed to one of serving military generals who were acting as corporate bosses, soldiering over tonnes of sugar, cement, and steel.

The nationalization of banks by Bhutto and the emergence of the small-scale manufacturing and services sector in the early 1970s broke the hold of the big industrialists, and permitted a new class of small industrialists to emerge. However, the real impetus to this middle class came as a consequence of the Gulf boom in the late 1970s and early 1980s.

In the period 1977–87, more than $20 billion was remitted into Pakistan by workers overseas through official channels. This figure ignores the large amounts which came in through unofficial means, which suggests that twice as much as the official figure may have been remitted to Pakistan. Jonathan Addleton,[6] in his excellent book on Gulf migration, has argued that this was the main reason why General Zia was able to have an essentially trouble-free decade. If the Soviet invasion of Afghanistan prolonged Zia's political career, the Gulf boom resulted in hitherto unheard of prosperity in most of the far-flung regions of Pakistan. While the amount remitted was itself very large, the geographical and locational dispersion of migrants, and hence remittances, was probably more important. Because this money was sent to numerous urban, peri-urban, and rural settlements of the country, it gave rise to economic development which was not concentrated in the more traditional regions of Karachi and central Punjab. The remittance economy permitted millions of individuals in thousands of villages to improve their standard of living by a considerable margin. It also gave rise to previously unskilled workers becoming shopkeepers, setting up small-scale industrial units, becoming transporters, etc. It allowed them considerable upward mobility and resulted in the broadening and strengthening of the middle class that had begun to emerge in the previous decade.

On the economic front, it was essentially Gulf remittances, money amassed though the massive black economy, and high growth rates that gave rise to the economic consolidation of the middle class, both urban and rural. On the political front, it was the reintroduction of the Local Bodies elections that led to the political emergence, and possibly even consolidation, of the middle class, both urban and rural. Given the intrinsic connection between politics and economics in Pakistan, it is not surprising that each reinforced the other.

Since 'real' elections to the provincial and national assemblies were not held under Zia until at least 1985 (and how 'real' they were is a moot point), most of the traditional political entities did not take the first Local Bodies elections seriously. Also, because severe restrictions were imposed by General Zia's government on participation, many stalwarts were excluded. This allowed those with some means, essentially the emerging middle class, to contest elections, perhaps for the first time. They were able to enter politics because the space had been created by the absence of the richer, more influential, traditional political actors. Local government seemed to work well under military dictators, and under Zia it seemed to work much better, because of the relative importance given to this tier of government by the large developmental funds channelled through it. Urban and rural councillors were the only elected representatives of the regime, and were responsible and accountable, given their limitations, to the needs and demands of the electorate.

Elections were held in 1979, 1983, and 1987, which allowed the same sections of the economic middle class to emerge as members of the political classes. General elections in 1985 even allowed some of the members to contest and

win elections at the national level, when parliamentary elections on a non-party basis were held.[7]

The main beneficiaries of the Zia regime were, then, members of the urban and rural middle classes, and members of the civil and, particularly, military bureaucracy. The large industrialists of the Ayub era also returned to Pakistan, although the nature of the entrepreneur under Zia was considerably different from that under Ayub. Rather than twenty-two families dominating Pakistan, there were perhaps a few hundred or a thousand under Zia. The industrialists under Ayub may have been richer than those under Zia, but there was probably less concentration at the top under Zia than under Ayub. However, despite this emergence of the middle class and of the new entrepreneur under Zia, political power was clearly retained in the hands of the military with a subservient bureaucracy alongside. Large landowners, too, had made a comeback under Zia, hovering around the political establishment and being allowed some room in the 1985 elections. Nevertheless, the power of the military was endorsed by the summary end to Mohammad Khan Junejo's tenure as Prime Minister in May 1988. The somewhat unique concept of a praetorian democracy worked rather well for many months, but once elements of the democratic forces began to impinge upon the terrain of the military, the military demonstrated that it was well in control.

The death of General Zia ul-Haq is still shrouded in mystery, and if it was not an accident, as many believe, his murder may have been an outcome of the struggle over the future course of Pakistan among members of the ruling clique, almost exclusively the military. The political process following the General's death, with the army remaining calm and allowing the electioneering process to take place, may suggest that members of the ruling establishment were responding to the developments that had taken place under General Zia and wanted to take them further. If this is indeed the case, then it seems that yet again, the contradictory results of certain policies undermined the ruler of the time. Under Ayub it was inequitable and uneven development that set forth socialist rhetoric; under Bhutto, the small-scale urban petit-bourgeois elements undermined his government; and under Zia, the middle class and its representatives, who owed a great deal to Zia in the first place, may have become more politically ambitious and assertive. Nevertheless, the period after Zia marks the first real demonstration and formal consolidation of the middle classes on Pakistan's economic and political map.

26.5 Elections Without Democracy: 1988–99

After the death of General Zia ul-Haq in 1988, Pakistan joined many of the developing countries which were on the road towards democratic revival. This was the time when Eastern Europe was experiencing the beginnings of change and where many previously authoritarian countries were shifting towards democracy. It was also a very unusual moment for Pakistan since the transition towards democracy was neither necessary nor certain. The Chief of the Army Staff at that time did not intervene in the process that had been announced by General Zia himself, and allowed the democratic process to evolve. (The fact that the army chief was to 'allow' elections to proceed, just shows the power and influence of this institution on the political life of Pakistan). The 1988 elections that were held in Pakistan were initially believed to be fair. However, the army and other military institutions' interference increased throughout the 1990s, so much so that the leader of the political party with the largest majority had to provide numerous assurances to different institutions of the state and give an undertaking that she would not upset the status quo which had emerged and that she would not initiate any campaigns of revenge. As we show in an earlier Chapter, Ms Benazir Bhutto also had to agree to the IMF programme that was signed just a few hours before she took oath as Prime Minister. While the election results were initially believed to be fair, the assurances and undertakings agreed to were not.

In the electoral interregnum of 1988–99 four elections were held, of which all were highly rigged and manipulated. The intrusive and secret arms of the state and of the military, set about creating political parties and alliances and supporting specific candidates. Moreover, they had a key interest and hand in dismissing both the Prime Ministers who emerged in this eleven year period. In 1991, these organizations, largely the ISI of the Pakistan military, helped create an alliance of political parties called the Islami Jamhoori Ittehad, which led to Nawaz Sharif being elected Prime Minister.[8] Nawaz Sharif and the group of people he cobbled together into his political party, were amongst the main beneficiaries of the economic policies of General Zia ul-Haq and a good representative of the economic and industrial elites who now joined politics. Local, provincial and national level economic actors were now forging themselves into political actors with relatives supporting different contesting political parties. The 1990s were the moment where the economic interests of middle class and elite Pakistan became articulated into politics, and into a desire to use politics for economic gain and for political power. As we argue above, individuals from the military had also independently (i.e. outside of the corporate interests of the military as an institution) acquired large amounts of capital, wealth and assets and were also now part of the new emerging political game. It is important to state, that this fusion of economic and political power amongst these groups, does not have anything to do with *democratic* politics. In fact, we argue in a section below, that once this fusion took place, and the middle classes acquired political power, they did not have any need for democracy; democracy and politics need not be coterminous.

Throughout the 1990s, and increasingly so as democracy 'failed' in Pakistan, the ISI and other bureaucratic and hierarchical non-democratic organizations and institutions began to interfere in and influence Pakistan's democratic transition. Evidence now about the 1990s shows that what was called 'democracy' in Pakistan was more a manipulation of political actors, processes and results, by such agencies, and less any sort of reflection of the 'will of the people' or about what people really wanted or opted for. While the new economic groups were staking their claim in the

political arena, their participation—as it was of everyone else—was dependent on the space allowed to them by the more powerful and organized institutions in the country. The economic transformation of Pakistan with the rise of the middle class continued, but their ability to participate in the political process was constrained and compromised by far more powerful institutional interests. Economic power increasingly rested with a middle class, but with regard to political power, they had to be junior partners with the military. There were eleven governments in office—and while they were in office one can't really say that they were ever in 'power'—during the 1988–99 period, with some governments consisting of technocrats from international financial institutions imported into Pakistan just for a few weeks. Clearly, the power to decide who was worthy of being in government throughout the 1990s, rested with groups and forces who had no tradition, experience or interest with democracy. This charade of who held real power in Pakistan, came to an unambiguous end on 12 October 1999.

26.6 The Return of the Military: 1999 Onwards[9]

Under the leadership of General Pervez Musharraf, the military claimed its central position in Pakistan's state structure and political scene, as it had in the past, far more decisively and overtly. The naiveté with which many of us believed throughout the 1990s, that the military had removed itself from power and had allowed the democratic transition to continue unhindered—as it had in some countries—received a rude shock with Pakistan's third military coup and fourth military head of government.[10] In more than the five years that the military government of General Musharraf had been around, in 2005, major world and regional events had taken place which had a significant political and economic bearing on General Musharraf, on Pakistan's economy and politics and on the process of democracy. Since many of the events and their ramifications have already been addressed in Chapter 18 (and also in Chapter 12, on devolution), here we merely summarize some of the arguments that concern us regarding our broader theme.[11]

General Musharraf took over power in 1999 just as two earlier generals had done, to save Pakistan and particularly from its politicians, to end corruption, and to put the economy on course to high growth. Pakistan's military's repeated interventions to put an end to democracy and to dismiss elected governments is legion, and the norm in Pakistan. General Musharraf and his men were simply building on that tradition. Analysis of the speeches of all Pakistan's military generals read out when they led coups dismissing elected and appointed governments, show very clear similarities.[12] There have also been numerous similarities in the way the military governments have ruled Pakistan. Attempts at devolution and the establishment of praetorian democracy, are two pet projects taken up by all military governments. General Musharraf, here too, was no different from military rulers of a previous era. Distorting, 'amending' and trampling Pakistan's Constitution, were also traditions which Pakistan's fourth military President followed.

Similarities also exist between circumstances which led to General Zia ul-Haq consolidating and extending his rule over Pakistan, and General Musharraf's years in power. The two invasions and occupations of Afghanistan, the first by the Soviet Union in 1979 and the other by the US some two decades later, in 2001, led to the entrenchment of military rule (particularly vicious and authoritarian under General Zia), at the insistence of the US, giving Pakistan the unenviable status of a 'front-line' state. On both occasions, Pakistan was ruled by the military, and on both occasions, with the very significant and overt help of the US, Pakistan's military dug deep into the state apparatus, putting any substantive form of democracy in abeyance. Also, under both Generals, Zia and Musharraf, one saw the economy grow significantly and remittances increased, and aid to Pakistan grew. The experiment of praetorian democracy, fashionable under General Musharraf, was already tried and tested under General Zia. Another trend to be consolidated under General Musharraf, as we argue in the section on General Zia above, was the growth and extensive involvement of Military Inc. in Pakistan's economy.[13]

There are, of course, numerous differences in both regimes as well. The nature of the military in Pakistan had changed compared to two decades ago, as had Pakistan itself. More important, the world and its political balance had changed with the end of socialism and the breaking up of the Soviet Union into numerous independent states. The world was a different place, with globalization now determining economic relations and the military might of the only super power left in the world, determining much else. In addition, despite the failure of many aspects of the democratic interregnum of 1988–99, the press and the media grew in strength and were far freer than in many decades, all making General Zia's rule very different from that of General Musharraf's. The global telecommunication and media revolution, where hundreds of channels were beamed into peoples houses in Pakistan, also made the 1980s very different from the early twenty-first century.

Five-and-a-half years into General Musharraf's rule, some trends were emerging which were different to those of earlier years. The most important difference seemed to be the almost formal cementing of the role of the military in Pakistan's constitutional set up, with the National Security Council having a critical role to play in the political process. The issue of whether a serving General, the Chief of the Army Staff, could hold the office of the President, also opened up a debate about formalizing the role of the military. With hundreds of serving and retired military personnel in public positions, the individual and corporate interests of the military had also been further entrenched and consolidated in the Pakistani state set-up. Perhaps, because of the US' War on Terror in Pakistan's backyard, one also saw far greater presence and influence of US foreign policy in determining domestic and regional policies. While Pakistan's numerous governments have always toed the US line, General Musharraf's government, since it was the main

beneficiary of this tacit submission, took this appeasement to new levels.[14]

Another important factor that emerged in Pakistan after 1999, had been the legitimization of the presence of Islamic parties in the political process in Pakistan. For the first time ever, Pakistan's religious parties were able to build an alliance, and to achieve an unprecedented electoral result, making this religious alliance an important component of the electoral process in Pakistan. Until the 2002 elections, religious parties were not central to the electoral process in the country, but by disallowing the three leaders of the most popular political parties to contest elections, General Musharraf had allowed the elected Parliament to be dominated by the religious right.[15]

Perhaps one of the more significant features of the Musharraf regime, unlike that of previous military governments, had been its ability to carry with it numerous differing social groups and factions. General Pervez Musharraf's regime was supported by large sections of the middle classes (of differing guises—see below); by political actors, most of whom belonged to these middle classes, who have had no qualms of shifting alliances where their politics has been based on opportunism and not principle;[16] by a section of civil society, which considered itself to be 'liberal' and democratic, which misled itself into believing that General Musharraf represented some form of enlightened moderation in terms of religious sentiment; by the military and the beneficiaries of military rule; and by a small, though powerful, economic elite which considered the policies of the Musharraf regime 'forward looking'. Unlike General Zia ul-Haq, for the most part, religious sections of society distanced themselves from the Musharraf government on account of his government supporting US foreign policy so blatantly, although they too have had an ambivalent relationship with the military, supporting it at times, and opposing it at others.

26.7 Issues in Pakistan's Political Economy

After evaluating the relationship and interaction of political and economic developments, trends and processes historically in this Chapter, we now try and briefly highlight some of Pakistan's core political economy issues and concerns which have emerged in recent years and affect both economic development, and the political process. We also look at groups, classes, and factions and examine how they influence the nature of Pakistani society today.

26.7.1 Pakistan's Middle Classes

The most obvious and noticeable phenomenon on the political, economic and social scene in Pakistan today, one which is linked closely with historical trends, is the buoyant and vibrant middle class revolution rampant in all parts of the country. From as far north as Skardu and Gilgit, through the plains of the Punjab and Sindh, to the coast of Karachi and the Mekran, a major transformation has redefined cultural, political, social and economic practices, identities and relationships (see also Appendix 26.1).

Probably the most significant symbol of the rise of a relatively well-to-do middle class is the excessive consumerism prevalent almost everywhere in Pakistan. It is not just large urban conglomerations which exhibit new consumer trends; the smaller rural and semi-urban towns in Sindh, Punjab and the NWFP, reveal the demands of a new breed of consumer. With transport more accessible and communications of all sorts improved, the further reaches of the country are being brought into the net of Pakistan's particular breed of private sector capitalism.

The middle-class revolution under way in Pakistan has taken place side by side with the failure of governance. The middle classes have recognized this failure of the government in its inability to deliver on its promises and has found its own solutions in the private sector. The most noticeable failure of the government has been its inability to cope with, and thus provide for, the growing need for social services. Hence, one of the biggest industries in recent years has been the private education and health markets. The growth in private sector social services emphasizes the vibrancy of the middle class where it has built institutions of varying quality for its growing clientele. Demand and the market, rather than the state and its political agenda, have determined these trends. In addition, the failure to provide protection for life and property, one of the major responsibilities of the state, has given rise to a protection industry which fulfils the needs of this class.

The ongoing middle class revolution does seem to have an economic agenda, but because this class had not fully consolidated its hold on power and had not emerged from its embryo totally, it had an unevolved clear philosophy and ideology. One of the developments of this growth has been a move away from regionalism and nationalism, into a more articulate, more composite, 'Pakistani' identity. The middle class which was earlier vociferous about its claim regarding the deprivation of 'national' rights in Sindh and the NWFP, may have evolved into an entity which was fully entrenched in the economic, social and political package called Pakistan. It saw its interest closely aligned to Islamabad, and the demands for autonomy gave way to increased access to the centre and secession for different ethnic groups, until the re-emergence of the military in 1999, no longer looked like a viable project.

With different factions constituting a loosely defined 'middle class', a more holistic stand on religion remains ambivalent. Nevertheless, because of the resurgence of a growing Muslim identity globally after 9/11, and as a consequence of the US invasions of Afghanistan and Iraq in the region, there has been growing and far greater identification with a broader Muslim and Islamic identity amongst middle class Pakistanis. In many ways, while economic interests may unite the aspirations of Pakistani middle classes, religious beliefs and social and cultural practices cause far greater divisions, weakening the notion of a single 'middle class'.

What do these general tendencies and trends regarding the economic process of development reveal about political choices? Does the presence of a vibrant middle class imply the election of a political leadership which focuses on

policies favouring this class? In answering this question, the excellent work by Andrew Wilder shows something that many analysts have not fully understood. In *The Pakistani Voter*, Wilder shows that Pakistanis vote, when allowed to, in a very rational manner, expecting favours and services for their vote to particular candidates.[17] His work shows that women, especially in the urban areas of the Punjab, vote independently of their male family members. While most analysts still harp on the tune that Pakistanis vote largely on the basis of the 'feudal' nexus, or on the basis of *biradari* and other kinship bonds, Wilder's work shows that the Pakistani voter casts his vote on an opportunistic basis expecting things to be done in return. This middle class revolution in Pakistan is restricted not only to urban areas, but also to an upwardly mobile rural capitalist middle class as well.[18]

Pakistan's middle class revolution had been in progress for some time but still had to concretize itself. While the Pakistani middle-class capitalist revolution may be far more advanced and progressive than the feudal (or whatever one wants to call it) system, it is not possible to romanticise about these middle classes. Pakistan's middle class, perhaps because of cultural factors, or as a consequence of negotiating with military dictatorships, or because it is still unable to come to terms with what it really is in terms of its own identity, was an evolving, immature, crude, greedy, selfish, narrow-minded middle class, whose only pursuit was self-interest. The type of democracy and the type of government which has existed in Pakistan (which Pakistan's liberal and westernised elite abhor), and to which this middle class belongs and subscribes, is very much a reflection of social, cultural and historical processes specific to Pakistan. We argue, perhaps in a deterministic way, that the aspirations of Pakistan's middle class reflect the essence of the particular nature of social, economic and political developments in Pakistan over many decades. There is a path-dependence to how society has evolved and how social groups within Pakistan, respond to different phenomena.[19] For this reason, comparisons made with other middle classes across the globe and across time, are perhaps misplaced—see section on the urban middle class below.

26.7.2 The Pakistani Military's Economic Interests and Their Consequences[20]

One of the facets of Pakistan's political economy and especially with regard to Pakistan's military, has been the military's growing corporatization and intervention and involvement as an economic, rather than simply a political, actor. With the growth of Military Inc. we see new vested interests and stakes being created by the military in the socio-political and economic structure that is Pakistan. While in the past, with little direct involvement in the economy, the military was merely a protector of Pakistan's geographical borders. As time went on and as the military became further involved in the political sphere, it claimed itself to be the protector of Pakistan's state, nation and domestic political arrangements as well. Along with this, it then moved on to become the sole guardian of Pakistan's ideological frontiers, defining what was permissible under its own interpretation of what Pakistan meant—*Pakistan ka matlab kya?*

Since the military has been in government for many decades in the past, it has also been a key player in the management of the economy, and has been the sole arbitrator and controller of issues regarding the defence budget. It has expanded its role to economic and political development as well, and considers itself 'an appropriate actor to enhance political and economic development, especially to fill the gap in these fields due to the absence of any other potent player with the capacity to do the same'.[21] However, it is only in more recent times that it has become an actor, a key one at that, *within* the economic structure of Pakistan. As Ayesha Siddiqa argues:

> the Pakistan military as a major stakeholder in the economy has gradually moved from the traditional paradigm of claiming [the] state's resources from the national budget to a situation where it has built stakes in all segments of the economy such as agriculture, service and manufacturing industries.[22]

Ayesha Siddiqa continues, that 'the military has arrived at the point where its business today control about 23 per cent assets of the corporate sector with two foundations, the Fauji Foundation and the Army Welfare Trust representing two of the largest conglomerates in the country'.[23] The political clout that the military has in Pakistan and the fact that it is more frequently a key part of the government itself, gives the military a dominating and overbearing advantage, which creates a very unfair, unequal, unlevel, playing field to its advantage. Because of the military's supremacy in Pakistan's political settlement and in the state, it has far greater power to influence economic decisions, both at a macro level related to the economy more generally, and also with regard to its own specific, micro-level interests.

While political reasons and interests are bad enough for militaries to interfere and intervene in a country's political process, when the military has substantial economic and financial interests and claims, it is less likely to give up control of the state or of its dominating position. Along with excessive allocations of the defence budget for its own interests—to which citizens of Pakistan have no right to information—the military can claim large resources for itself especially when it is itself the government. It appropriates civilian positions and a large chunk of the administrative budget meant for non-military personnel, is funnelled through to serving and retired military officers. The newspaper *Dawn* reported that there were 'as many as 104 serving and retired Lieutenant Generals, Major Generals or equivalent ranks from other services [who were] among the 1,027 military officers inducted on civilian posts in different ministries, divisions and Pakistani missions abroad *after* the October 12, 1999 military takeover'.[24]

Clearly, the civil-military divide has became further divided and formalized in a manner that benefits the military far more than it does Pakistan's non-military citizens. As Ayesha Siddiqa argues, the military's economic interests create

> a vested interest that would discourage the armed forces from allowing democratic institutions to function', and since its economic empire has been constructed on the basis of the military's dominating political and institutional power, further encouragement for the military to enhance its economic power would lead to it increasing its entrenchment in politics.[25]

This link between its political and economic role and interests 'runs the risk of creating an environment where the military finds it more beneficial to stay in politics'.[26] Clearly, democratic forces in Pakistan have had to contend not only with the military's political ambitions and agenda, but as much with its economic programme and interests.

26.7.3 Pakistan's Praetorian Democracy and Technocrats as Apologists

One of the more innovative inventions of Pakistan's military has been the creation of a form of *praetorian democracy*, where some form of electoral and democratic participation has been grudgingly allowed to by the military when it has been in power. General Ayub Khan allowed some degree of local level participation in the 1960s, as did General Zia ul-Haq in 1979. However, the latter permitted far greater participation in the elections of 1985, when provincial and national elections were held. General Musharraf continued this tradition of allowing this particularly Pakistani version of democracy to emerge, where elections have been held despite the military ruling the country and running government. Hence, the so called 'democracy' that has been permitted by the military has been very partial, controlled (even manipulated), and highly incomplete.

The fact that the military *allows* or *tolerates* democracy in Pakistan, only reaffirms the arguments made in this Chapter about the power and control of the military over civilian institutions, issues and concerns. While some analysts feel that it is the *compulsion* of the military which makes it permit some largely symbolic and ineffective civilian representation, this view fails to take full cognizance of the might and power of the military. The fact that it can undertake coups which are disallowed by the Constitution of Pakistan, that it can dismiss Parliaments and governments, or that the military can replace Prime Ministers because they may have taken some (minor) issue with the Army head displeasing or criticizing him, only emphasizes the view, sadly, that the military has been the most powerful, intrusive and undemocratic institution of the state in Pakistan. By creating a system of praetorian democracy, the military continues to hold complete power and runs the country how it feels fit and according to its own particular agenda. When things go awry, it blames the politicians it itself helped create. Isabel Hilton, writing in *The New Yorker* argues, that

> During Pakistan's existence, no political party has successfully resisted military pressure. Each time the Army seized power, it has promised to clean up corruption and to strengthen democracy. Each time, military rule has been extended. The ISI has constantly meddled in and manipulated civilian politics, creating political parties, distributing large sums of money to favoured candidates, and fomenting violence among rival groups. . . . The idea, then, is to maintain its influence through a mixture of force, mediation, and interference in civic institutions.[27]

In its attempts to rearrange Pakistan's political structures and social set-up, the military also relies on numerous Pakistani technocrats who show a great eagerness to join non-elected civilian (caretaker) and military governments. It is this attempt to address Pakistan's governance problems through fiat and through managerial and administrative interventions, which distinguishes representative from non-representative governments. While many of the elected governments of Pakistan have had recourse to technocrats as well, the military and Caretaker governments have a particular liking for such individuals. Moreover, it is the ability to use its dominating power to distribute favour and patronage, which attracts such bureaucrats to non-elected military regimes. This is more so in the case of bureaucrats from international financial institutions who play important roles in running key ministries and institutions related to finance, commerce and development. By relying on technocrats, military governments argue that their brief is to address and solve Pakistan's problems, not to ensure participation or representation. Many of these technocrats, who would probably never be part of any elected government in Pakistan, often become the biggest apologists and collaborationists for military regimes in Pakistan.[28] International bureaucrats, untrained in any democratic tradition, much like the military itself, see themselves as part of an administrative and managerial elite whose role is to solve Pakistan's problems, and not particularly to build or further support Pakistan's weak and underdeveloped democracy—see also Box 26.1).

26.7.4 Pakistan's State and Society: Groups, Factions, and Influence[29]

This discussion in this chapter shows very clearly that Pakistan's military has been the most powerful and influential institution in the country. It dictates politics, foreign policy and now increasingly has a deep interest in the economy, making it Pakistan's most important interest group. It is responsible for creating its own form of democracy—a praetorian democracy—and soon after creating governments and building up individuals as Prime Ministers, dismisses them as easily. The military intervenes in the democratic process in Pakistan whenever its leaders believe that Pakistan is in 'danger' or in 'trouble' and rescues Pakistan from itself. The fact that it has the power of the gun and excessive power at that, allows it to impede any form of development related to the political process with which its leaders do not agree. This has led some observers to argue, that Pakistan is not a country with an army, but an army with a country.

The fact that the military—specifically, the army—dominates the state and its institutions, does not mean that there are no other contending institutions and social groups who have a bearing on state and society in Pakistan. In the

1960s, the analysis of the state in Pakistan suggested that along with the military, it was the bureaucracy and the large landlords—often called 'feudals'—who controlled the state. In the 1980s, the military was back in power and was the most important component of the state once again, this time in partnership with Islamic groups and a rising industrial and service sector bourgeoisie. The middle class, which is non-institutional and cuts across different ideological divides, has numerous factions as part of it. Rather than a single or some unified class, it is perhaps more useful to talk about social forces as 'fractions and factions'.[30] Moreover, it must be remembered, that there is a dynamic notion of the state, classes and fractions, which keep changing as social and property relations change: 'The composition and organization of the economically dominant group is relatively fluid, and the state itself is involved in the process of class formation'.[31] Perhaps the use of categories such as social groups and factions are preferable concepts to understand 'the complexity of socio-political phenomena in developing countries'.[32] Moreover, the nature and even *quality* of the state in its role in capitalist accumulation, is fluid and changes. Ali Cheema in an excellent article argues, that 'state intervention in Pakistan was consistent with the patterns of *efficient accumulation* during the sixties, but this correspondence had broken by the eighties and nineties. During the latter period we witness *inefficient corruption*'.[33] Cheema argues that over time, the state has become more 'politicised' and become a partner in corruption and rent-seeking, leading to these inefficient outcomes.

During the Zia period, what one can call the socially conservative and religious sections of the middle class, supported the military government, while the liberal and 'progressive' elements of this class were against him. With the military back in government (it has always been in power, however) in 1999, it once again began to dominate the institutions of the state, however, with Pakistan's social structure and group formation having undergone considerable change, this time with a different set of actors and social groups.

If one were to identify the main social groups and actors in Pakistan in 2005, one would probably include the following: the military, Islamic political groups, members of Pakistan's civil and political society and of NGOs, international powers and donors, and segments of the middle class who are to be found in all institutional and ideological moorings. The military as an institution, has representatives from very poor social and economic backgrounds, as well as from the very well-to-do elite, a position to which many serving and retired senior officers rise; it also has members of Pakistan's conservative middle classes safely entrenched in the military's political world view.

Box 26.1

The Military and Democracy in Pakistan

When in power, military regimes have not worked either to establish effective conditions for the return to civilian rule or to develop institutions that might make military usurpation unnecessary in the future. Rather, they have focused on immunizing themselves against criticism and deflecting any popular challenges that might arise. More dangerously, in an effort to ensure their survival and mitigate perceptions of their illegitimacy, military regimes have repeatedly undermined centrist social forces and political parties in Pakistan by encouraging radical political groups opposed to democracy. They have also deliberately privileged party-less local governments over central and provincial institutions because the former typically cannot threaten core military interests relating to security policy, national budgets, and economic organization.

If Pakistan is to become a moderate Muslim state that exists in peace with itself, its neighbours, and the international community, its political process must be reformed. A stable, successful Pakistan will be a democratic regime governed by a constitution that incorporates effective checks and balances. A civilian government, freely and regularly elected, responsible to the constitution, and protected by the military as part of its constitutional responsibilities, will advance the marginalization of radical Islamist forces in Pakistan.

Only the establishment of democratic institutions and stable civilian rule offer some hope of overcoming the myriad challenges confronting Pakistan today, including resolving the security dilemmas with India that drive the military's support for Islamist terrorist groups; removing the economic distortions that privilege military expenditures over social investments and that create the preconditions for the rise of disaffected Islamists; and correcting the failures of command politics associated with military ascendancy, which prevents the national interest from being defined by open competition in a vibrant civil society.

The resuscitation of democracy in Pakistan offers no guarantee that it will successfully break out from its current state of morass. The absence of democracy, however, will almost certainly ensure the perpetuation of dangerous structural trends that will lead inevitably to state breakdown. Moreover, the failure of previous attempts to institute democratic reforms should not deter future efforts. Democratic civilian rulers held office in 1973–1977 and 1988–1999, but their fear of military interference kept them focused primarily on self-preservation rather than good governance. The missteps of these democratic moments in Pakistan's history should not be used as an argument against the restoration of democracy. Rather, they underscore the importance of military abstention from rule.

Source: Ashley Tellis, 'US Strategy: Assisting Pakistan's Transformation', *The Washington Quarterly*, vol. 28, no. 1, 2004, 104–5.

Religious Forces and Groups

The rise of Islamic political groups having an influence on Pakistan's political and social structure, is nothing new. Pakistan has had such groups playing important roles in politics since Independence. However, what has changed overtime, has been their influence on social norms, society more generally, and on the political process. Pakistan is a country where 97 per cent of the population is Muslim. *Culturally and socially, Pakistan is a Muslim state. It is not an Islamic state,* a distinction which is very important to understand social norms and practices and the idea and nature of transition in Pakistan. In Pakistan, religious customs and in some cases, practices, dominate the cultural and social milieu of the people. While all Pakistanis may not be practising Muslims, all are believers and are conditioned by the broad religious environment in which they are located. Islam has an omnipotent presence in the lives of all Pakistanis, and they are conditioned by this. However, the fact that Pakistan is a state composed of Muslims and is not strictly an Islamic state, has important repercussions on society.

While Islam is probably the most significant marker in the lives of almost all Pakistanis (certainly all Muslims, and most non-Muslims as well), their politics and social relations are not strictly determined by this marker, although perhaps cultural practices are. As actors in society, Pakistanis are influenced by numerous other influences, as much as they are in taking political actions and making political choices. Although Islam and religious parties have a strong influence on the lives of Pakistanis, it does not mean that they have been the preferred choices whenever Pakistanis have been allowed to vote. Religious parties had not won more than a handful of seats in elections prior to the 2002 Musharraf elections. They have, nevertheless, always been in close alliance with the military since at least General Zia's reign in the mid-1970s; in fact, it was with their help, in the guise of the Pakistan National Alliance (PNA) that Zia came into power and legitimized his coup. Fringe Islamic parties and sections of mainstream Islamic parties, have also been active in jihad in various countries and regions, ranging from Kashmir and Afghanistan to Chechnya.[34] These groups and organized parties have also had considerable street power in Pakistan and continue to make a mark at a local level. They have not had a significant electoral/Parliamentary presence until recently. As a major elected group in Musharraf's Parliament, Islamic parties were also in a position to directly influence the partially democratic and constitutional process in Pakistan after the 2002 elections.

After 9/11 and the US invasion of Iraq, there has been a rise of a greater Muslim identity globally, often articulated in an anti-Americanism and anti-globalizm fashion as well. There is also a noticeable resurgence of Islamic identity in Pakistan, manifested in changes in attire and in discourse, amongst the middle classes in Pakistan. A greater awareness about Islam, attending sermons and participating in religio-cultural events, seem to be on the rise amongst the urbanized sections of Pakistan's society. Islam manifests itself widely at a social level and any examination of social and political practices and processes in Pakistan, must contend with this reality. In Pakistan, as in so many Muslim countries, Islamic beliefs do also very comfortably sit with modern, even western, beliefs and practices. They are accommodated without much tension and contradiction. Yet, there is also a rejection by many believers in Pakistan of a modern and western way of life. A divide between those believers who accept, work with, and accommodate 'western' beliefs and practices and those who reject them, exists in Pakistan, and it is difficult to predict where such divisions will lead society in Pakistan.[35]

Global Powers and International Influences[36]

Pakistan has been a beneficiary and victim of international influences and actions on numerous occasions in the past, and one cannot ignore such forces in today's unipolar world. Economic assistance and aid has been critical for Pakistan's survival at various times in the past as we show in many of the chapters in this book—see Chapter 25. Since its earliest days it has had a close military and political alliance with the United States of America, an alliance which has wavered greatly over time. With the US clearly being the far dominant actor in this relationship, it has set the terms of this rather unequal relationship, which has usually been short-term and from the point of view of the US, highly opportunistic. In 1979, when the Soviet Union invaded Afghanistan, the US backed General Zia to fight its proxy war against Soviet expansionism in the region. History repeated itself with the US invading Afghanistan in 2001, with General Musharraf ensured of US support and political longevity, as once again Pakistan becomes the US' front-line state, fighting its War against Terror in the region. While General Musharraf had been the beneficiary of this support—see Box 26.2 and Chapter 18 as well—Pakistan suffered as a consequence.[37] The democratic process, certainly, has been put aside as the US was more concerned with supporting General Musharraf fight its War on Terror than on supporting democratic processes and parties in Pakistan. Unquestionably, support and involvement from foreign powers, has a great influence on political, democratic and social outcomes in Pakistan.[38]

The support for General Musharraf by the US in today's age, reflected the duplicity of US foreign policy. Pakistan from 1999 was a country ruled by a military ruler who overthrew a democratically elected Prime Minister and illegally and unconstitutionally dismissed Parliament, and despite instituting a praetorian democracy, Pakistan remained undemocratic; Pakistan had ample weapons of mass destruction (WMDs) in the form of nuclear war heads, and unlike in the case of Iraq, one did not need UN weapons' inspectors to verify the truth of this claim and has had US sanctions imposed upon it as a consequence; Pakistan had also been caught in the act of nuclear proliferation selling nuclear secrets to North Korea, Iran and Libya as recently as autumn 2003[39] and the individual who took the blame for this proliferation, Dr A. Q. Khan, confessed publicly to this indiscretion; Pakistan also had active and armed Islamic militant and fundamentalists group located in the country, as well as perhaps, hundreds of al-Qaeda and Taliban supporters

Box 26.2

Pakistan's Real Bulwark

Amid the turmoil in Iraq and signs that Afghanistan still lacks a viable state, it's not surprising that doubts about the ability of the United States to support democratization are growing in the Middle East and even in the United States. This is all the more reason why the success of a homegrown democratic process anywhere in the Muslim world is so important—especially in a strategically located nuclear state such as Pakistan. But is US policy helping to achieve this end in Pakistan?

Deputy Secretary of State Richard Armitage has called Pakistan's President Pervez Musharraf 'the right man at the right time'. President Bush wants Congress to reward the Musharraf government with a five-year, $3 billion assistance package, even as his administration turns a blind eye to the Pakistani military's possible involvement in proliferation of nuclear materials to North Korea, Iran and Libya. Indeed, the Bush administration recently proposed that Pakistan be designated 'a major non-NATO ally'.

Much of Musharraf's status as the 'right man' stems from Pakistan's help against al Qaeda and, crucially, the belief that Pakistan's military is the best bulwark against the growth of Islamic extremism in a nuclear state. As proof of the threat in Pakistan, it is noted that two of the country's four provinces are already much under the sway of Islamic extremists in the Muttahida Majlis Amal (MMA) or United Action Forum, an alliance of six Islamist parties.

But before Congress authorizes the 'bulwark fee' to Musharraf, it should consider the following: In the 1993 elections, fundamentalist parties won only nine of the 217 national assembly seats. In the 1997 elections, they were reduced to two. But in October 2002, three years after Musharraf's 1999 coup, the MMA Islamist alliance secured 45 of the 272 national seats, and in the strategically crucial North-West Frontier Province, it won 48 of the 99 contested provincial assembly seats.

More directly damning for the bulwark thesis, there is strong evidence that Musharraf and the Pakistani military contributed to this result. Two major moderate parties, Benazir Bhutto's centre-left Pakistan People's Party and Nawaz Sharif's center-right Pakistan Muslim League-Nawaz, won about 70 per cent of the vote (and seats) in the general elections of 1993 and 1997. Musharraf and the military correctly viewed these two parties—and especially their leaders—as the most powerful challengers to his claim to rule in the 'supreme national interest', and they have kept the two former premiers virtually in exile. On 12 April Javed Hashmi, acting president of the Muslim League, was sentenced to 23 years in prison for defamation of the military. The military regularly used force to curtail the freedom of the two moderate parties in the 2002 elections. Meanwhile, it gave the Islamists free rein to hold rallies.

Among many other ways the military aided the fundamentalist parties was by decreeing that only candidates with a bachelor's degree could run for national or provincial election. This disqualified about half the previous incumbents of moderate parties from competing. At the same time, graduation from madrassas, the Islamic religious schools, was allowed to count as a bachelor's degree, so virtually no MMA candidates were blocked.

Despite all this military help for the Islamists, the surprising but under-recognized fact is that the MMA won only 11.1 per cent of the total vote in Pakistan's last national elections. Our evidence suggests that far from being a 'bulwark', the military is actually a facilitator of Islamic extremism. Worse, after helping to marginalize the traditional moderate parties, the military is in danger of becoming beholden to the extremist parties, which in fact cast the deciding vote to constitutionalize many of Musharraf's self-granted powers.

Congress is considering the administration's $700 million annual budgetary request for Pakistan. It might also decide to discuss legislation, introduced by Rep. Gary Ackerman (D-N.Y.), stipulating that the president must certify that a country is a democracy and is participating with the United States in advancing global non-proliferation efforts before declaring it a 'major non-NATO ally'.

There is much else to consider. The president's Pakistan aid package calls for $300 million a year in military aid but only about $20 million for primary and secondary education. One of the reasons so many poor Pakistanis send their children to madrassa hate factories is that the amount Pakistan spends on public education is among the lowest in the world as a percentage of its economic output.

Democracy in Pakistan has not been weak because of Islamic extremists. In the six national elections held since 1970 for which party-based vote shares can be determined, extremists have not managed to garner more than 12 per cent of the vote. Elected politicians have not covered themselves in glory. But one of the major reasons that democracy has been weak in Pakistan is that, in its 56 years of independence, not one elected government has been allowed to finish a full term.

The 'right person' for the United States and Pakistan is a prime minister put in office by free elections and allowed by the military to finish his or her full term of office.

Source: Alfred Stepan and Aqil Shah, in *The Washington Post*, 5 May 2004.

and sympathisers. With these credentials, Pakistan ought to have been part of President George Bush's 'axis of evil'; yet, from the status of a near 'rogue' state in 1998, Pakistan had within five years, in the eyes of the US State Department, graduated to a status of a 'major non-NATO ally'. Not many states have made such a speedy transition in the eyes of the US government within a matter of a few years.

The US reliance and emphasis on General Musharraf supporting the US War on Terror in the region, gave him a deal of support. Over the 'uniform issue' for example, when General Musharraf went back on his promise made to Parliament at the end of 2003, that he would not hold both offices, that of the Chief of the Army Staff and of President, the then US Secretary of State of the US Colin Powell said that

'Pakistan was moving in the right direction under President Pervez Musharraf', and that 'a little bit of understanding is necessary' to deal with General Musharraf.[40] By supporting a military government at the cost of democracy in Pakistan, the US undermined not just the democratic process itself, but perhaps by a rather myopic and opportunistic foreign policy objective, that might have created bigger problems in the future, not just for Pakistan, but perhaps even for itself. In the context of Pakistan-US relations this was nothings new: 'The United States has traded democracy for security in Pakistan before and is doing so once again. . . . With every periodic engagement, Washington bolsters the idea that a military regime is better suited to the people of Pakistan. There are no benchmarks, no conditionalities on the $3 billion military and economic aid package announced last year for Musharraf'.[41] The US support for General Musharraf in its War on Terror, helped concretize and strengthen the institutional role of the military in Pakistan, something that has been done on numerous occasions in the past.

Pakistan's Civil Society

While there have been failures of democracy in Pakistan, of the state, and of governance, and despite the dominance of the military in Pakistan's state and society, there has also been a noticeable failure of Pakistan's civil society. Social groups and institutions located outside of government and not working purely for profit in the private sector; groups of academics, intellectuals and journalists; political groups and parties; non-governmental organizations and community and neighbourhood organizations; and other groups which in some way are perceived to be of a liberal bent, working to change/improve society, with some notion of justice, all tend to constitute what is commonly called 'civil society'.[42]

Civil society, or at least important sections of it, are perceived to be groups which keep a check on government, and keep niggling government regarding its policies and positions. The notion of civil society is not static and is a dynamic concept across time and region. What constitutes civil society in one era, may change form. The social and political groups which constituted civil society in Eastern Europe in the Soviet era, were transformed into statist and government organizations, often becoming oppressive and as authoritarian as the statist institutions they replaced. Now, new social groups, often in opposition to the first in these countries, constitute civil society. Also, in stable democracies, the notion of civil society is very different and changing, from that found in undemocratic regimes. Although there is a tendency to use the term 'civil society' rather unscientifically and loosely, it is not always an easy concept to understand or locate.

In Pakistan, the tendency has been to restrict the notion of civil society to NGOs and other groups, because they are seen to be working for change. Advocacy NGOs and groups, often criticizing government and ostensibly working for democracy, have been active components of civil society, as have writers and intellectuals. Yet, when these same groups have become apologists for government, particularly military rule, and have joined and become partners in military governments, their credentials to be part of 'civil' society have to be questioned. In fact one would argue, that once civil society actors join the 'other side', they are no longer part of civil society.

One major reason why the military tends to dominate state, society and politics in Pakistan, is because of the failure of civil society in Pakistan. Like other social actors in Pakistan, members of civil society have been eager to be co-opted and 'serve' military governments, as has most recently been seen after General Musharraf's coup in 1999. Like technocrats, who perhaps make no qualms of their distaste and distrust of democrats, civil society groups and actors, many of whom have at least joined the chorus in favour of democracy in the past, also eagerly embraced General Musharraf and his government and endorsed the military coup in 1999. Important, well-respected and articulate members of Pakistan's civil society became ministers in the Musharraf government and justified their support for military government at the cost of democracy, by arguing that a liberal and efficient non-elected, undemocratic, authoritarian government, was preferable to an illiberal, inefficient and increasingly authoritarian democracy. For these actors, democracy as it was practiced in Pakistan, had failed and was secondary, and what mattered was not a civilian/military distinction, but apparently, liberal values emanating from the person of one General, were preferable to illiberal policies being pursued by elected representatives. Pakistan's civil society has had a key role in strengthening and supporting military government in Pakistan at the cost of democracy in the past. Members of the intelligentsia and academics in Pakistan, have done no better and have had no qualms in supporting military rule in preference to Pakistani style dysfunctional democracy. Unlike many other countries, in Pakistan, civil society actors and groups have been *collaborationists*, not *confrontationalists*, working with military governments, not against them.

26.7.5 Urbanism as a Way of Life

In recent years, a number of social scientists and urban planners in Pakistan have been critically examining demographic, political and social issues and the nature and question of transition in Pakistan. Much of their work and analysis has been on the growing urbanization of Pakistan, on Pakistan's middle classes and on what Lewis Wirth has called 'urbanism as a way of life'. Their basic argument has been that Pakistan is now largely urban and social and cultural, and most certainly economic, relations are predominantly urban.[43] This perspective also gives rise to discussion on Pakistan's middle class and its impact on society. This section of this Chapter, raises some of the issues that have been articulated by the idea that Pakistan is now urban, and we try to assess how this urban phenomenon has an impact on state, society and transition in Pakistan.

The main argument that these scholars make, is that Pakistan no longer has isolated 'rural' communities or settlements, that there are strong cultural, economic and social linkages which tie-in urban and so called rural areas. Rural populations and lifestyles are now perceived to be part of a continuum which is predominantly urban in complexion

and integrated with the urban and even with the global. Rural areas now have 'ribbon like settlements' that are intertwined with the urban.[44] Those areas which still have agrarian economies, have been so densified that they are now being called 'ruralopolises'. Mohammad Qadeer calls the process of spatial organization taking place in Pakistan and elsewhere, where rural areas have lost their traditional form, 'ruralopolises'.[45] Ruralopolises are settlements of urban-level population densities with an agrarian economy, and is not simply the periphery of an urban settlement, but extends far beyond a city's region. Urban level densities in rural areas have transformative force, where they 'change spatial organization, the settlement pattern, the form and structure of villages and the land economy, including the provision of housing lots'; one outcome of this process is the 'changing economic and functional bases of all levels of settlement hierarchy'.[46] As Qadeer argues, 'it is becoming difficult to differentiate urban from rural areas. The homogenising influences of the nation-state, the industrial mode of production and the communication revolution have almost eliminated conventional differences'.[47] In northern and central Punjab as well as in the heartland of the NWFP and in Sindh, there are contiguous districts which comprise major cities, medium sized towns and peri-urban settlements, and have formed into a large and significant urban system, with ribbons of urban settlements fusing into one another.[48] Mohammad Qadeer shows that

> 'from Sialkot to Multan, an area 55,738 sq km . . . is a densely settled region dotted with cities, towns and sprawled villages and hamlets. . . . From Gujrat to Lahore and then onward to Multan, one is always in urban presence. Spatially this area is one extended urbanizing region, one ruralopolis. The second ruralopolis is centred around Peshawar and extends across Peshawar Valley and beyond into lower reaches of Swat Valley. Karachi to Hyderabad is already a corridor of urban settlements'.[49]

For Qadeer, as much as 56.5 per cent of Pakistan's population is 'urbanized by one or the other process of urbanization'.[50] For him, 'villages are being infiltrated by motor cycles, videos, tea shops, snooker clubs, telephones and workshops, namely the cultural artefacts forged in urban areas. . . . The sum total of this argument is that purely rural population is a minority in Pakistan and even it is coming under urban influences'.[51] Urbanization emerges as a catalyst for social and economic change and lays the bases 'for the realignment of social organization and the redefinition of social relations as well as cultural norms'.[52] Urban and rural areas are being brought together resulting in the 'urbanization of everybody' and of everyday life, as rural areas assume urban characteristics.

Ali Cheema's work on social classes on Pakistan over time, has shown the location of the urban intermediate class which is an important part of the dominant coalition of classes in countries like Pakistan, and includes the urban lower middle classes, the educated and professional groups, and traders and medium and small industrialists, many of whom have evolved from rural backgrounds.[53] The rapid growth of urban towns and cities in the 1960s in the Punjab came about as a consequence of social, economic and political changes that took place following the Green Revolution. The political bargaining power of this urban intermediate class had increased substantially by the late 1960s. In the late 1970s, the absence of political stalwarts in local bodies elections 'resulted in intermediate class-led factions capturing urban local bodies under the Zia regime, with large developmental funds at its disposal'.[54] Also, 'medium-sized capitalists and traders who emerged as an essential part of the core of urban political factions were able to capture Chamber of Commerce politics at the Punjab and the federal level. This became an important mechanism to enter national politics for small and medium sized capitalists and traders, who emerged as key members of these fragmented factions'.[55] As a result, many urban local bodies councillors and businessmen and traders, graduated from the local level politics of the 1970s to the national and provincial assemblies of the late-1980s.[56] As a consequence and through this process, the state was increasingly captured by these urban groups, many of whom were in partnership with the rural dynamic capitalist groups and the rural middle class, backed by traders. Along with substantial remittances from the Middle East which helped consolidate the economic, social and political position of many rural intermediate classes, and with demographic changes, an urban *Pakistan had been formed and consolidated*.[57]

For Cheema, this demographic, economic and social transition taking place, resulted in creating 'fragmented and decentralized cross-class factions', and that there was 'significant upward mobility into the ranks of the industrial class, by allowing members of the urban intermediate class easy access to state 'transfers' and especially state credit'.[58] There was also a change in the overall social profile of entrepreneurs from non-capitalists to capitalists. New social groups were being formed which were very different from the earlier 'established' industrial houses. Many of the new breed of industrialists had links with the heartland of urban Punjab and had become politically integrated with the system. Arif Hasan argues that the increasing importance of urban middle classes in Punjab's politics in the 1970s and 1980s, was underpinned by the socio-economic changes that the agriculturalists confronted, who were dependent on *mandi arhtis* and their transporters who controlled credit as well as the access to mandis with the connivance of the bureaucracy.[59] A new nexus of middleman-bureaucrat-local politcian-transporter, emerged in mid-level and small towns in the Punjab.[60]

Whereas, the earlier industrial groups in Pakistan kept their considerable distance from popular politics (although had close links with the state and its institutions), this new breed of trader and industrialist, *was also a political and politicised actor and also, continued to have strong links with the state*, although the nature and form of the state had changed markedly since the 1960s and 1970s. In many ways, as a consequence of the social and economic change that had taken place in Pakistan since the 1960s and 1970s, *the state in Pakistan by the time of the mid-1980s, was a far more participatory and inclusive state, reflecting the changed social and economic relations and modes of production.*

Perhaps because of these changes, it is also a much weaker state than it was in the 1960s.[61]

Throughout the 1980s and 1990s, urban political parties consolidated their presence and hold on the political map of Pakistan largely through the process of local level elections. Cheema et al. argue that

> the accommodation of urban middle class interests continued after the revival of elected federal and provincial governments as there was a steady consolidation of Punjab's urban middle class vote in favour of Nawaz Sharif's Muslim League. The political and economic consolidation of Punjabi urban middle class groups was facilitated by increased remittances from migrant workers in the Gulf and due to fast rates of urbanization.[62]

Politics also, in many ways, throughout the 1980s under General Zia and the military, became localized, and patronage, personalized. In some ways, the culture of the politics of the local level was elevated and transplanted to the chambers of the national and provincial assemblies.[63] What is interesting, and as pointed out by Ali Cheema and his colleagues, is that while local government (decentralization) reform has been enacted in Pakistan by the military to centralize its control over the state, it has led to a fragmentation of political issues, localizing them, leading 'to the reversal of a more universalistic basis of political organization',[64] making politics simply a game of patronage.

This section, and in fact much of this book, has been arguing about the dominance of an *urban Pakistan*, one that is increasingly non-rural, non-agricultural, and certainly not 'feudal'. One, where social, economic, political and cultural trends and development are urban rather than rural. We have also argued that *Pakistan is now dominated by urban middle class factions and social groups, and has an urban, modern, feel to it.* Urbanization has laid the 'bases for the realignment for social organizations and the redefinition of social relations as well as cultural norms'.[65] Yet, while this demographic, cultural and social account is real, it had not brought about a progressive political movement which is modern or democratic. Unlike other countries where the rising urban middle classes have struggled for collective social emancipation and for democracy, Pakistan's middle classes have, in the past, preferred to become partners of authoritarian and military governments. These groups have not been a 'natural' ally for democrats and have displayed opportunistic (though perhaps, rational) behaviour, compromising at each historical juncture. Perhaps it would be no exaggeration to state, that based on experience and example from recent years, *there is no substantial real and concerted constituency in Pakistan for democracy*, and people in general, and the urban middle classes in particular, have largely been interested in fulfilling their narrow economistic goals and interests. Or, as we also argue, perhaps these classes have partly captured the state and find representation more manageable through alliances and *jore-tore*, rather than through the cumbersome and less certain path of participation.

26.7.6 Is Pakistan a Failed State?

Pakistan has failed as a democracy in the past and has been ruled by military governments, now for more than half the years since independence. For much of its 66 years, it has been highly dependent on aid and foreign loans and much of the economic growth that has taken place, has been on account of this aid; in addition, it has outstanding debt equivalent to nearly the full amount of its GDP. Its social sector indicators are abysmally poor, and in the decade of the 1990s, Pakistan's comparative position in terms of per capita GDP and in terms of human development, fell markedly. Pakistan has been on the precipice of being declared a 'rogue' state and has been caught in the act of nuclear proliferation. Clearly, in absolute terms and relative to other comparable nations, many of whom are now well on the track to high economic growth and also have well-established democratic, civic and judicial institutions and structures, *Pakistan is a failed state*. While Pakistan is certainly not an Afghanistan or Somalia, it is also not South Korea, Malaysia or Brazil. It has been left behind even by Bangladesh, which seems to have overcome its wobbly transition to democracy and has had higher economic growth rates than Pakistan, throughout the 1990s. Perhaps interest in Pakistan and its importance to the rest of the world, is premised simply on the fact that it is a 'strategically located nuclear state', and nothing more. If this is Pakistan's only claim to international recognition and fame, it is very much a failed state.[66]

Numerous institutions, groups and actors must take responsibility for Pakistan's many failures. Political parties and their leaders, along with members of the bureaucracy, have been responsible for looting the country and bringing it on the verge of bankruptcy and financial ruin, on more than one occasion. International actors have used Pakistan for their own designs, abandoning it whenever their dirty deeds and wars have accomplished their particular goals. Pakistan's civil society and its middle classes are to blame for taking opportunistic and selfish political stands, who are eagerly and willingly co-opted by authoritarian governments, seldom taking stands and positions for the general good. But perhaps, in terms of institutions, it is the military which needs to be held far more accountable than any other group or institution, for making Pakistan a state which continues to fail. By having far more power than any other institution and for misusing that power, the military in Pakistan must take a great deal of the responsibility for the way Pakistan has evolved. Even when not directly involved in government, the military and its institutions have always ruled. While politicians have been irresponsible when in power, they have never held the extent and degree of power that the military in Pakistan continues to hold. Hence, any sort of comparison between democracy and dictatorship, is unfair and unreasonable.[67]

There is a very obvious and growing disillusionment with the state and its institutions in Pakistan. The general feeling is that the state has failed to deliver on basic issues, that it can no longer govern, administer justice, provide essential and basic social services, or collect taxes, and its only function seems to be coercive, with institutions of law and order increasingly turned, not towards protecting the life and

property of citizens, but in being used against the people of Pakistan. Corruption is noticeably rampant, and affects all institutions of the state, and the decline of state authority and credibility is obvious.

This, perhaps, is the key crisis of the state in Pakistan. It is probable that the reason why the state and its institutions are in such disarray is that, as we have emphasized above, society has been transformed quite radically in Pakistan over the last few decades, and probably the state has not been able to understand or keep up with the nature of these changes. The crisis in Pakistan exists due to the mismatch of the state with the needs, demands, and aspirations of the new Pakistan. While the 'old order' is now redundant for much of Pakistan, its persistence in the realm of the state and its institutions, results in the many crises that are so visible. The key political struggle of the emerging economic and political classes in Pakistan will have to be over who rules the state, but more importantly, what is to be the nature of the state which reflects this new and emerging society. Unless this issue is resolved, and for as long as it is contested, Pakistan is more than likely to be involved in an endless stream of crises and failures.

26.8 Summary and Further Reading

26.8.1 Summary

The key argument made in this chapter, written primarily in 2005, is that Pakistan emerged as what we consider to be, an economy dominated by a middle class, which also consolidated its hold over political power by becoming part of Pakistan's 'nexus of power'. We do not subscribe to the view that 'feudals' hold power, an economic category which this book has argued, is redundant. Large landowners do wield political clout in areas which they dominate, but as a consolidated political category, they have diminishing political representation and strength. Traders, small and large industrialists, transporters, educated and semi-educated urban dwellers, capitalist farmers and small scale manufacturers, seem to dominate the economy, and have somewhat, cashed in on their economic strength to share political power. Even sections of the petit bourgeois and lower middle classes who have little economic power, in the sense that they do not have substantial ownership of assets, are now important holders of political power, most noticeably in Karachi and in other towns in Sindh, as well as in the Khyber Pakhtunkhwa where the religious parties have such groups as their prime constituency. The political equation has, not at all surprisingly, changed from one where large landowners held sway, to where they are now for the most part marginal, and have been replaced by middle-level industrialists and other elements of the service sector, both in urban and rural Pakistan. These groups, for the most part, have been able to increase their share in the power structure through access to a nexus and network of economic and political arrangements. Perhaps along with other actors, since they have even been able to capture the state, they have seen no need for participation or democracy in the past.

This realignment of the political settlement in Pakistan, does not detract from the fact, reiterated again in October 1999, that the military held complete power over all institutions of the state, and ran the country the way it seemed desirable. We also argue that by virtue of having been the most powerful actor and institution in Pakistan, the military needs to answer for much of Pakistan's failure. However, some of these failures have to be shared by civil society, by politicians, and by international powers—who continue to prop up unelected, illegitimate, military governments—as well. Whether Pakistan will emerge as a modern, developing state, with some real demonstration of democratic processes and institutions, with social and political justice its cornerstone, still needs to be seen.

26.8.2 Further Reading

There are some excellent books which are essential to understand the nature and relationship between politics and economics in Pakistan. See Shahid Javed Burki's, *Pakistan: A Nation in the Making* (Boulder, Colorado: Westview Press, 1986). See also Zaidi, S. Akbar, 'How the Bourgeoisie Views Pakistan', *Economic and Political Weekly*, vol. 23, no. 48, 1988, for a critique of the book. Shahid Javed Burki's, *Pakistan Under Bhutto 1971–77* (London: Macmillan, 1980) is also recommended. Khalid bin Sayeed, *Pakistan: The Formative Phase 1857–1948*, (Karachi: Oxford University Press, 1978) and *Politics in Pakistan: The Nature and Direction of Change* (Connecticut: Praeger Publishers, 1980) are also recommended. Also see, Gardezi, Hasan and Jamil Rashid (eds.), *Pakistan: The Roots of Dictatorship* (London: Zed Press, 1983); Ziring, Lawrence, *The Ayub Khan Era: Politics in Pakistan 1958–1969* (New York: Syracuse University Press, 1971); Kochanek, Stanley, *Interest Groups and Development* (Lahore: Vanguard, 1984); Jalal, Ayesha, *The State of Martial Rule: The Origins of Pakistan's Political Economy of Defence* (Cambridge: Cambridge University Press, 1991); Addleton, Jonathan, *Undermining the Centre: Gulf Migration and Pakistan* (Karachi: Oxford University Press, 1992); Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Lahore: Vanguard, 1986); Noman, Omar, *The Political Economy of Pakistan* (London: KPI, 1988); Papanek, Gustav, *Pakistan's Development: Social Goals and Private Incentives* (Cambridge, MA: Harvard University Press, 1967); and Waseem, Mohammad, *Politics and the State in Pakistan* (Lahore: Progressive Publishers, 1989).

Amongst more recent publications see: Ishrat Husain's *Pakistan: The Economy of an Elitist State* (Karachi: Oxford University Press, 1999), and *Economic Management in Pakistan 1999–2002* (Karachi: Oxford University Press, 2003); Pervez Hasan's, *Pakistan's Economy at the Crossroads* (Karachi: Oxford University Press, 1998); Iftikhar Malik's, *State and Civil Society in Pakistan* (London: Macmillan Press, 1997); Arif Hasan's, *The Unplanned Revolution: Observations on the Process of Socio-economic Change in Pakistan* (Karachi: City Press, 2002); Andrew Wilder, *The Pakistani Voter: Electoral Politics and Voting Behaviour in the Punjab* (Karachi: Oxford University Press, 1999); Soofia Mumtaz, Jean-Luc Racine and Imran Ali (eds.), *Pakistan: The contours of state and society* (Karachi:

Oxford University Press, 2002); Khalid Nadvi and S. M. Naseem (eds.), *The Post-colonial State and Social Transformation in India and Pakistan* (Karachi: Oxford University Press, 2002); Anita Weiss and Zulfiqar Gilani (eds.), *Power and Civil Society in Pakistan* (Karachi: Oxford University Press, 2003); Owen Bennett-Jones', *Pakistan: Eye of the Storm* (New Haven: Yale University Press, 2002); Mohammad Abdul Qadeer, *Pakistan: Social and Cultural Transformations in a Muslim Nation* (London: Routledge, 2006); and S Akbar Zaidi's, *Pakistan's Economic and Social Development* (New Delhi: Rupa, 2004); S. Akbar Zaidi, (ed.), *Continuity and Change: Socio-Political Dynamics in Pakistan* (Karachi: City Press, 2003) and S. Akbar Zaidi, 'Contested Notions of Pakistan', *Economic and Political Weekly*, vol. 47, no. 45, 10 November 2012—also see some of the notes/references in Chapter 27.

Appendix 26.1

Radio as a Social Metaphor

This article interprets the form and content of the new FM radio stations opened in Pakistan and argues that they act as a mirror of the nature of Pakistani society.

The extraordinary revolution that has taken place in Pakistani society is best captured by the form and content of the new FM radio stations operating in the cities of Islamabad, Lahore and Karachi. The music played, the dialogue and language used by the DJs, the conversation between callers and show hosts, and the entire package and style of FM 100 is an accurate manifestation of a new generation of Pakistanis that is coming of age. The style of the radio station is lively, and upbeat, youthful and optimistic, reflecting the new, particularly urban, indigenous middle class culture which has increasingly come to dominate this nation.

Most of what is played in the three cities on FM 100 is a new Pakistani music which now influences the lifestyles of many young urbanites. It is modern in style and critically dependent on the use of modern instruments and technology. The harmonium and tabla have been replaced by electric keyboards and guitars, and harmony by noise. While the FM radio stations play much more of this kind of music—a clear reflection of the social and cultural changes that have taken place in the country—the airwaves are not restricted solely to new Pakistani music. Just as Pakistani society is hybrid and constitutes a large part of the old with the new, so is the repertoire of FM 100.

Despite the waves of modernization sweeping Pakistani society, numerous traditions and older forms and values continue to persist. FM 100 reflects this eclectic composition in its choice of music, with a good dose of ghazals and the music of yesteryear thrown in. Just as in our society, where the old and the new compete for social space, on the radio, too, tradition and modernity vie for air time.

If the newly westernized indigenous cultural and social norms of the country are reflected in the new Pakistani music played on FM 100, the radio stations also imitate the process of globalization and internationalization so integral to present day Pakistan. Each day, FM 100 dishes out a large dose of current western music for its Pakistani listeners, with a weekly spot for the latest from the US top 20 hit list. What is most interesting, however, is the fact that even when Pakistani society was dominated by the westernized elite a couple of decades ago, western English music played on the radio was restricted to only half an hour each day. But now, with Pakistan an active part of the global market and of the westernized world _ and despite the fact that the westernized elite no longer governs _ the amount of western music on the airwaves has increased. However, the major difference is that now this English music runs far deeper roots into urban middle class society than ever before, whereas in the past it was restricted to a very small section of the westernized elite.

No matter how modern Pakistan may become, however, it is highly improbable that religion will cease to play a role in the lives of this nation. FM 100 recognizes this social reality, and new Pakistani music or the latest music from the US suddenly comes to a halt at the time of prayer. Then, the moazzin's call is beamed out to the faithful, followed by a naat and qawwali. Just as Pakistan balances its modernity with religion, so does the new radio station. Moreover, the fact that FM 100 is permitted to air the music it does, despite the protestations of the religious lobby which considers such music and its connotations vulgar, is possibly the best indication of the social and political reality in Pakistan today where global and modern forces have marginalised religion and religious forces in the public arena. Had a dominant or even effective religious sentiment existed in Pakistani society, FM 100 could not have played the music it does.

If the music played on FM 100 is one symbol for what constitutes contemporary Pakistan, the nature and content of the dialogue and language used by the DJs is another. The puritanism and tradition of the old order has been lost to a new language which forms part of urban middle class culture. The Urdu that the urban middle classes spoke up to a generation ago contained few words from the English language. Today, it is unlikely that this class can speak a single sentence without a smattering of English. As the isolationism of the past has given way to a global or western order, colloquial Urdu too has lost much of its pristineness. Interestingly, the earlier impact of Bollywood on Urdu seems to have been replaced in the very recent past by a bombardment of English words on the Pakistani language. The DJs on FM 100 articulate this phenomenon perfectly as is best demonstrated by the following instructions to their listeners: aap apna face soap say wash kar key towel say dry kar lain.

Despite the movement towards a modern society, one aspect of the old which continues to persist is that of the extended family. Listening to FM 100 confirms this aspect of

Pakistani society. The phone-in on air, on its own, is a good mirror of many features of Pakistani society. A lone caller is seldom heard, and one often hears the DJ talking to the entire family of the caller. It happens very matter of factly with the telephone being handed from the female to another, from daughter to mother and sister to cousin. If the family is considered to be an extension of one's self in South Asian society, the phone-ins on air mirror this social reality.

Pakistani society has yet to acquire the curtness and brusqueness of the modern world, and the deference for the old order continues. This too is reflected in the mannerisms of the DJs and show hosts. Despite being in great pain over the belligerence and persistence of some callers, they are unable to slam the phone down and continue to tolerate each and every caller until they have spoken to their heart's content. The callers are almost invariably female and hail mainly from middle class localities in the city. Some conversations take place totally in English, an English which itself makes interesting listening. Most callers, however, speak Urdish, increasingly the lingua franca of this urban middle class.

For any astute listener, FM 100 presents the best caricature of contemporary Pakistani society in all its forms. After a few days of listening one can get a fairly accurate picture of modern urban middle class Pakistan. This relationship between what we hear and what we are, is not simply unilinear. Rather, it is a dialectical relationship where the airwaves play a critical role in determining social and cultural history. If entertainment and awareness about the world around us is one of the more positive attributes of FM 100, alienation from one's own culture and context may be its biggest failing. Questions-for-cash on FM 100 stations, for example, ask listeners to name the team which currently heads the US NBA championship, or to give the names of all the members of Bon Jovi or Salt n Pepa, two American bands. This is utterly absurd, to say the least. These competitions on air seem to be the strangest and most unreal aspect of a package which, for the most part, gives a fairly decent reflection of the Pakistan urban middle class scene. However, what at present seems to be a distortion may yet turn out to be the harbinger of a new, thoroughly Americanised order some years from now. But if our own economic and political alignments with Washington today are any indication, one may not have long to go before what at present sound like the most absurd questions, become culturally very contextual and relevant.

FM 100, in its own way, represents deep rooted changes that have taken place in Pakistani society and culture, a transformation that has found expression in numerous ways. Contrary to what most intellectuals argue, Pakistan is a vibrant and dynamic capitalist country and the perception that a feudal order still holds sway over a large section of the population is utterly fictitious. Ours is no longer an 'agricultural' or rural society, and agriculture's contribution to GDP is now less than that of the industrial or service sectors. In fact, today agriculture contributes only half the share contributed by the services sector.

Over the last two decades, there has also been a large scale migration from the rural areas to towns and cities, with urban culture now dominating almost the entire country. Ours is a thoroughly consumerist society, and we have acquired what many would call the worst attributes of the western capitalist nations without imbibing the more positive social, political and cultural mores which are part of the bourgeois order.

In the age of openness and globalization, Pakistani society is now also more internationalized and westernized than it has ever been in the past. Through instant access of the media, news, information and values are immediately communicated to us from different parts of the world. The isolationism of the past has been broken, probably for ever, by the integrating forces of the new world disorder. With the collapse of the Soviet Empire, at least for the moment, only one economic, social and political system determines the history of humankind. Ironically, in an age that supposedly offers unprecedented freedom and choice, the choices available for the evolution of society seem to be restricted to only one.

Internally, the social and economic fabric of the country has also undergone an unprecedented metamorphosis in the last two decades. The westernized English speaking elite has been replaced by a more indigenous elite whose mother-tongue is most likely to be Punjabi or Pushto but is increasingly speaking a great deal of Urdish. The bureaucracy, military and business classes are now more often of lower middle and middle income origins. Never before has there been as much social mobility—both upwards and downwards—as has been witnessed over the last two decades. The English speaking elite would probably be the first to bear witness to this development, clearly demonstrated by its own loss of exclusive privilege and power.

In a nutshell, then, Pakistan is a modern, dynamic, capitalist country where a dominant indigenous, badly westernized urban middle class rules. Gone are the days of the feudal and of big landlords with their endless hours of leisure. As a result, tradition as expressed in social graces and in music, has also been lost. Possibly the best reflection of this extensive change is the new sound on the airwaves. Indeed, FM one hundred may be a better mirror of our society than we first imagined.

Source: Zaidi, S. Akbar, The Herald, Annual, January 1996. This is an edited version.

Notes

1. See the excellent article by Ali Cheema, 'State and Capital in Pakistan: The Changing Politics of Accumulation', in Reed, A. M., *Corporate Capitalism in Contemporary South Asia: Conventional Wisdoms and South Asian Realities* (London: Palgrave, 2003), in which a political economy perspective is presented on class and state formation in Pakistan.
2. Burki, Shahid Javed, *Pakistan: A Nation in the Making* (Boulder, Colorado: Westview Press, 1986), 112.
3. Ibid.

4. Ibid. 54.
5. In a list of Pakistani dollar billionaires and millionaires published by the *Wall Street Journal*, of the top seventeen names on that list, eight were either retired military officers or sons of retired military generals, seven of whom made their fortunes during the Zia years (*The News*, Karachi, 18 July 1997). Moreover, General Fazle Haq, a close contemporary of General Zia and Governor of the NWFP during much of the Zia Martial Law, was considered to be one of the richest serving military personnel in the world.
6. Addleton, Jonathan, *Undermining the Centre: Gulf Migration and Pakistan* (Karachi: Oxford University Press, 1992).
7. In 1985, of the 240 Punjab MPAs, 124 were sitting Councillors; of the eleven metropolitan/municipal corporations of Punjab and Sindh, at one time or another, mayors of *ten* have been either MNAs or MPAs; in the elections held in 1993, it was estimated that more than 70 per cent of members of the Punjab and National Assemblies started their political careers from local bodies. See *The News* on Friday, Special Report on Local Bodies, 30 September 1994.
8. See Amir Mir, 'Political Outfits Raise ISI Bogeyman Alarm', The News on Sunday, Karachi, 4 February 2001; and The *Herald* Annual, Karachi, January 2001, which carries a number of articles on how 'the intelligence agencies have continually warped not just the political process but also public perception and debate in Pakistan'; also see Benazir Bhutto' interview in the same issue.
9. See my series of articles that were written following General Musharraf's coup in October 1999, Zaidi, S. Akbar: 'A Benevolent Dictatorship?', *Economic and Political Weekly*, vol. 34, nos. 42 and 43, 16–22/23–29 October 1999; 'Pakistan: Democracy, Development and Dictatorship', *Economic and Political Weekly*, vol. 34, no. 45, 6 November 1999; and 'Why Pakistan's Military Government Will Fail', *Economic and Political Weekly*, vol. 34, no. 49, 4 December 1999.
10. I was also amongst those who were naïve enough to believe that the military had allowed the election process in Pakistan to take place somewhat independently. For this reason, when the First Edition of *Issues in Pakistan's Economy* was written and published, the military did not feature as an important enough institution to warrant comment. Similarly, I must also confess that when the Second Edition was published in 2005, I did not see the possibility of a democratic or popular movement emerging and maturing into what it did.
11. Also see: Zaidi, S. Akbar (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003).
12. See the issues of *Herald* and *Newsline* in 1999 and subsequently, when such analysis was made.
13. See the extensive work of Ayesha Siddiqa on this and her forthcoming book, provisionally titled *Military Inc: The Political Economy of Generals in Business*. See: Siddiqa-Agha, Ayesha, 'Power, Perks, Prestige and Privileges: Military's Economic Activities in Pakistan', paper presented at the Soldiers in Business: Military as an Economic Actor Conference, Jakarta, 17–19 October 2000; 'The Political Economy of National Security' in Zaidi, S. Akbar (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003); 'The Politics of Military's Economic Interests', unpublished paper written for DFID, 2004. Also see some of the other articles in Zaidi, S. Akbar, (ed.), op. cit., 2003.
14. See Tellis, Ashley, 'US Strategy: Assisting Pakistan's Transformation', *The Washington Quarterly*, vol. 28, no. 1, 2004; and Schaffer, Teresita, *Pakistan's Future and US Policy Options* (Washington DC: Centre for Strategic and International Studies, 2004).
15. See some of the articles in Zaidi, S. Akbar, op. cit., 2003. Also see Haqqani, Husain, 'The Role of Islam in Pakistan's Future', *The Washington Quarterly*, vol. 28, no.1, 2004.
16. See Zaidi, S. Akbar, 'The Politics of Opportunism', in Zaidi, S. Akbar (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003).
17. Wilder, Andrew, *The Pakistani Voter: Electoral Politics and Voting Behaviour in the Punjab* (Karachi: Oxford University Press, 1999)..
18. See Hasan, Arif, *The Unplanned Revolution: Observations on the Process of Socio-economic Change in Pakistan* (Karachi: City Press, 2002).
19. However, clearly, this does not mean that there is no *agency* in the process and that all agents are prisoners of their structure. While both, agency and structure determine and reinforce each other, our understanding of Pakistan's state and society is, that the structure is dominant, and conditions agents' behaviour and responses.
20. This section draws largely on the work by Ayesha Siddiqa cited above.
21. Siddiqa, Ayesha, op. cit., 2004.
22. Ibid.
23. Ibid.
24. *Dawn*, Karachi, 3 October 2003. Emphasis added; also see Ayaz Amir's article: 'How Many Generals Can a Country Afford?', *Dawn*, Karachi, 1 March 2002.
25. Siddiqa, Ayesha, op. cit., 2004.
26. Ibid.
27. Hilton, Isabel, 'The General in his Labyrinth; Where will Pervez Musharraf Lead his Country?', *The New Yorker*, New York, 12 August 2002.
28. See in particular: Ishrat, Husain, 'Pakistan's Economic Progress since 2000: False Dawn or a Promising Start?', Lecture given at the School of Advanced International Studies, Johns Hopkins University, Washington DC, 6 October 2004. Also see Ayesha Siddiqa's article, 'Dancing the Donors', *The Friday Times*, Lahore, 15 October 2004. Also see Zaidi, S. Akbar 'Influencing from Afar: The Role of Pakistani Diaspora in Public Policy and Development in Pakistan', in Yong, Tan Tai and M. Mizanur Rahman (eds.) *Diaspora Engagement and Development in South Asia* (Basingstoke: Palgrave, 2013).
29. It is important to state that many of the ideas raised in this section of this Chapter, with regard to classes, groups, fractions, etc., are still somewhat tentative. I am still in the process of thinking through many of the themes and thoughts raised here, and am presenting them here in order to trigger broader debate about such themes and issues.
30. See Khan, Foqia, 'Capitalist Transformation, State, Social Groups and Law: A Case Study of Pakistan', unpublished mimeo, January 2004.
31. Khan, Mushtaq, 'Clientleism, Corruption and Capitalist Development: An Analysis of State Intervention with Special Reference to Bangladesh', unpublished PhD Dissertation, University of Cambridge, 1989, cited in Khan, Foqia, Ibid.

32. Ibid.
33. Cheema, Ali, 'State and Capital in Pakistan: The Changing Politics of Accumulation', in Reed, A. M., *Corporate Capitalism in Contemporary South Asia: Conventional Wisdoms and South Asian Realities* (London: Palgrave, 2003), 139, emphasis in original.
34. See the excellent book by Ahmad Rashid: *Taliban: Militant Islam, Oil and Fundamentalism in Central Asia* (New Haven, Connecticut: Yale University Press, 2001) for how Pakistan's army and its Interservice Intelligence (ISI) trained Islamic militants and sent them to fight numerous wars across the globe.
35. For more analysis and interpretation on this theme see Aslam, Talat, 'Zia's Children: Young Pakistanis in a Changing World', and Hasan, Arif, 'The Process of Socio-economic Change in Pakistan', both papers presented at the Conference: *The Future of Pakistan: The Politics and Economics of Development*, held at the School of Advanced International Studies, Johns Hopkins University, Washington DC, 8 November 2004.
36. We have discussed economic and financial influences in many chapters of this book, and in this section talk only about some contemporary foreign policy aspects.
37. Stephen Cohen, an American strategist, has argued that 'Pakistan has rented out its army to Washington'.
38. Also see Tellis, Ashley, op., cit.
39. See Christopher Peeble and Subodh Atal, 'Pakistan Nukes Present Challenge, but Bush, Kerry not Responding', *Chicago Sun-Times*, Chicago, 11 October 2004.
40. *Dawn*, Karachi, 20 October 2004.
41. Sirohi, Seema, 'Denying Democracy', *Outlook*, web edition, www.outlookindia.com, 23 November 2004.
42. For an excellent discussion on the idea, theory, existence and practice of civil society, see: Kaviraj, Sudipta and Sunil Khilnani (eds.), *Civil Society: History and Possibilities* (Cambridge: Cambridge University Press, 2001).
43. The social scientists and scholars who have been studying social change in Pakistan and have been talking about an urban Pakistan are: Reza Ali, Ali Cheema, Arif Hasan, Mohammad A Qadeer, and S. Akbar Zaidi.
44. Ali, Reza, 'Underestimating Urbanization?', in Zaidi, S. Akbar (ed.), *Continuity and Change: Socio-Political and Institutional Dynamics in Pakistan* (Karachi: City Press, 2003).
45. Qadeer, Mohammad, 'Ruralopolises: The Spatial Organization and Residential Land Economy of High-density Rural Regions in South Asia', *Urban Studies*, vol. 37, no. 9, 2000, and 'Urbanization of Everybody: Institutional Imperatives and Social Transformation in Pakistan', Paper presented at the 15th Annual General Meeting and Conference of the Pakistan Society of Development Economists, November 1999.
46. Qadeer, op. cit., 1999.
47. Qadeer, op. cit., 2000, 1590.
48. See Ali, Reza, op. cit.
49. Qadeer, op. cit., 1999, 9.
50. Ibid.
51. Ibid., 10. Qadeer also talks about cities being 'ruralized' as migration from villages continues. However, we do not agree with his argument, and while there is migration to cities, the city norm becomes the dominant norm and villagers have to fall into an urban space quickly in order to exist and survive in the city.
52. Ibid. 18.
53. Cheema, Ali, op. cit. This and the next paragraphs draw on Cheema's work.
54. Ibid. 156.
55. Ibid.
56. Ali Cheema shows that by the 1985 election, the proportion of industrialists in the national parliament had increased considerably, and this was a 'very different' industrial class, not like that of the 1960s. Cheema, Ali, op. cit., 165.
57. For the process of social change triggered off by remittances, see the excellent book by Addelton, Jonathan, *Undermining the Centre: The Gulf Migration and Pakistan* (Karachi: Oxford University Press, 1992).
58. Cheema, Ali, op. cit., 158.
59. Cited in Ali Cheema et al. 'Decentralization in Pakistan: Context, Contents and Causes', draft, forthcoming in Bardhan, Pranab and D. Mookherjee, *Decentralization in Developing Countries: A Comparative Perspective.*, Also see, Cheema, Ali and Shandana Khan Mohmand, 'Local Government Reforms in Pakistan: Legitimizing Centralization or a Driver for Pro-poor Change?', unpublished mimeo, Lahore University of Management Sciences, Lahore, October 2003.
60. See Hasan, Arif, *The Unplanned Revolution* (Karachi: City Press, 2002).
61. Ali Cheema argues that in the 1960s there was a small, centralized, bureaucracy and a small and politically weak capitalist class, and a consequence of this interaction resulted in 'efficient accumulation'. This structure unravelled in the 1970s and the state weakened and was fragmented, and there was also 'fragmented growth of politically mobilised "transfer-seeking" coalitions that were bidding for state "transfers"'. The structure of decentralised corruption was institutionalized by Ziaul Haq, who incorporated these fragmented factions in the state structure and further unravelled the rule-based nature of the state'—Cheema, Ali, op. cit., 162.
62. Ali Cheema et al. op. cit.
63. See the excellent work by Andrew Wilder on Pakistan's elections: *The Pakistani Voter: Electoral Politics and Voting Behaviour in the Punjab* (Karachi: Oxford University Press, 1999).
64. Cheema, Ali et al. op. cit.
65. Qadeer, M, op. cit., 1999, 18.
66. However some writers disagree with the notion that Pakistan is a failed state. Nasim Zehra writing in the *Gulf News*, 10 December 2004 says: 'Now past the label of a "failing state", Pakistan is being viewed as a "reforming state" with a pivotal role in global affairs. . . . its conduct of policy on other fronts [post–9/11] have positioned it as a responsible state.'
67. This comparison has been the pastime of apologists of military rule who use selective facts to show that military rule has been 'better' for Pakistan than has democracy. For the latest proponent of this idea see Husain, Ishrat, op. cit.

27 A New Political Economy?

This, the last chapter of this book, is divided broadly, into three parts. Section 27.1 deals with the narrative of events and transitions from the mid-2000s to the elections of 2013. It provides an account and interpretation of key developments in this period, and links well with the analysis of Chapter 26. Section 27.2 examines the structures of political economy in Pakistan, constructed primarily by Hamza Alavi, since then revised and reformulated by others. Section 27.3, based on how Pakistan may be changing significantly, is more reflective and speculative, and offers a sketch of thinking about a new political economy of Pakistan.

27.1 Transitions

27.1.1 The View in Mid-2011: Was Pakistan Near Collapse?

Given the numerous events which took place around June 2011, if one were to ask the question, 'Was Pakistan collapsing?', based on a long list of events and responses around them, one would have unambiguously answered with a definite 'Yes'.

For instance, we now know that the world's most wanted and most notorious man, declared a terrorist by the world, including the Pakistani civilian and military establishments itself, was found to have been living in close proximity to Pakistan's elite Military Academy, perhaps since 2005. This led to the suggestion, that Pakistan's military leadership, or some elements of it, knew this fact and had offered protection to him, and had been complicit in harbouring the world's most wanted terrorist. If not quite complicit, then the military high command—for it is only the military which matters in this situation and in such relationships, as it held all power and made all decisions related to so called security—was incompetent in not knowing that he was living so close to the General Headquarters and other military stations, and not in Waziristan, or hiding in Afghanistan, or preferably dead and buried somewhere in the mountainous region.

This presence of Osama bin Laden led to the extraordinary event, of the US Navy SEALs invading Pakistan, violating its air space, carrying out a military operation for forty minutes, destroying their own helicopter, killing bin Laden and his accomplices, perhaps capturing some individuals, and safely returning to their air bases in Afghanistan. Along with this, the US military also buried the dead bin Laden at sea, and if it was, as one suspects, the Arabian Sea, that would have meant another flight of more than an hour over Pakistan's air space.

This event led to a severe reprimand and dressing-down for Pakistan's military, civil and secret services, by officials of the US, leading the international condemnation for housing a terrorist which caused great embarrassment to the Pakistani military. On numerous occasions the word 'duplicitous' was used by the US, charging Pakistan's military of playing a double game. Having provided $20 billion since 2001, the US was asking how its money had been spent and whose side Pakistan's military really was on—see Chapter 25. While the military was quiet—it took days for it to publicly respond to all these allegations and charges—the civilian political actors, both of the government and outside of it, screamed that 'the nation's sovereignty' had been trampled upon, and one heard loud cries of 'how dare they' resonating in Parliament, and of course, in Pakistan's hugely independent media.

This led to the call for an 'enquiry', a Parliamentary resolution condemning the action, and such responses by the government and opposition. It also led to an unprecedented presentation by the senior military leadership, the Director General Inter-Services Intelligence in particular, in the presence of the Chief of the Army Staff, to Parliament. This might have been the first time that the military leadership in Pakistan was made to explain something of such national importance to elected civilian representatives. Not following the defeat in the 1971 war during the first democratic government in Pakistan, or after the 1977 coup or the 1988 plane crash which killed General Zia, or after Kargil, or following the ouster of General Musharraf, had the military leadership been asked to explain itself. While the implications of this are discussed below, what transpired was that the DG ISI, a serving General, offered to resign, 'if asked', he added, while making his presentation to Parliament.[1]

Soon after these developments relating to Osama bin Laden, a terrorist attack took place at a militarized Navy base in Karachi where, according to different reports, four or ten militants held the airbase and its residents hostage and captive, where a state of siege lasted for around eighteen hours or so, after which the base was eventually 'liberated'. While there have been a number of attacks on military establishments in Pakistan over the last decade, including one extremely embarrassing one at GHQ in Rawalpindi in October 2009, where numerous military men were held captive, the brazen attack on PNS Mehran in Karachi, so soon following the events outlined above, caused considerable concern among naval actors as well as members of political parties and civil society. There were calls for the resignation of the Naval Chief and acknowledgement of massive military (or state) failure. It was believed that most of the attackers

were Pakistani militants, and may have belonged to any one of the numerous terrorist organizations in Pakistan, but perhaps even to the military services themselves. In other words, an 'inside job'.

Soon after these events, a well-respected journalist, Saleem Shahzad who, like a number of Pakistani journalists, had been reporting on terrorism and militants—perhaps the only story in town—was picked up, tortured and then murdered at the end of May. In the past, whenever military or civilian men had been picked up, tortured and killed by groups which can broadly be called 'The Taliban/Al-Qaeda', there had been an announcement made that so-and-so was murdered by such-and-such group because he was an 'American or CIA agent', a traitor, or an informant. The groups which do the killing give their reasons for killing the individual concerned. In the past, there have been allegations that even the Military Intelligence or ISI or some other state institution, threatened and roughed up civil society members and journalists.

Immediately after Saleem Shahzad's murder, the ISI issued a statement that they did not kill the journalist. This was quite unprecedented, since the ISI seldom makes such announcements. It was forced to do so because Saleem Shahzad had actually been picked up by the ISI in October 2010, something that they acknowledged, and he had warned his friends that he was receiving threats for his reporting. His last two stories had argued that 'The Taliban' had infiltrated the Pakistan Navy and that the Navy was trying to cut a deal with some known militants and that the deal had gone wrong. Hence the attack on PNS Mehran.

All these events and their consequences, took place within a single month. If one were to step back and start from January 2011, at least one (and probably many more) significant events and responses to it, which have a bearing on the Pakistan-is-collapsing thesis, is worth noting. In January that year, the Governor of Punjab, Pakistan's largest province, was assassinated in the afternoon by his own bodyguard. His bodyguard confessed to his crime and claimed that he had murdered the Governor because the Governor was trying to repeal the Blasphemy Law. Broadly defined, this Law, introduced by General Zia ul-Haq in the 1980s, was meant to deliver the death penalty to anyone who committed blasphemy against the Prophet of Islam (PBUH), against the Quran or against the religion of Islam. A number of individuals are in jail on account of the Blasphemy Law awaiting trial or having been sentenced, awaiting execution. Moreover, many of those who have been accused on account of the Blasphemy Law, have been killed in extra-judicial killings committed by individuals or organizations. With a Christian woman convicted to death on account of the Law, many individuals were agitating for amendments to the Law and in the way individuals were targeted. There was little mention of a repeal. The Governor of the Punjab was one of those individuals. His assassin said that the Governor was, in fact, trying to repeal God's Law and hence he killed him.

What happened after the assassination concerns us here. Firstly, the self-confessed assassin of the Governor, was hailed as a champion, a *ghazi*, a fighter for the cause of Islam. He was garlanded by a large number of lawyers when he was presented in court, and there were few lawyers willing to take up the case against him. While the social media such as Facebook and the like are not as prevalent as in Egypt and elsewhere, where it has been part of social movements recently, a Facebook account in support of the assassin was set up and apparently had thousands of followers. Moreover, the overly active and zealous electronic media had numerous analysts appearing on live television defending the assassin, or at least not condemning him outright, while a few, very few, liberal participants did. The ratio of those who thought this was a heinous crime to those who defended him or were apologists for his cause, would be close to 1:30.

The death of the Governor led to a number of other outcomes or responses as well. First, there was complete silence from the main political parties, the Pakistan People's Party and Nawaz Sharrif's Muslim League. Very few members of either party, including senior government and political officials, dared to attend his funeral. Neither the Chief Minister of the Punjab nor his brother, Nawaz Sharif, went to pay their condolences to the assassinated Governor's family, especially in a society and culture where such condolence visits are mandatory and cut against all personal or political prejudices and animosity. In death, the Governor, who had a very colourful social life and a long political career, was ostracized like he had never been when alive, only out of fear that anyone seen as sympathetic to him would also be considered a sympathiser of someone who actively wanted to repeal the Blasphemy Law and was hence, in some way, anti-Islamic.

One can add an even longer list of events and their consequences and outcomes and not dwell on the question any longer and say that Pakistan was on the verge of collapse. From drone attacks to constant admonishing from the Obama administration, to a weak economy, an insurgency and target-killing of the non-Baloch in Balochistan, and a weekly dose of suicide attacks on common people, all supported this conclusion. This became the conventional wisdom from Pakistanis and others, as well.

However, this Section argues that this was actually not the case. That, in fact, what these and other events suggested was, that there was a growing crisis and contradiction *within and between the institutions of the state* in Pakistan and, in fact, these crises and contradictions, evaluated differently, might offer a completely divergent narrative. What may have been collapsing, was the *political settlement* that had existed for many decades and, in fact, these could be seen as very positive developments.

A Different Explanation

If some of the events in the month of May 2011 were quite unprecedented even for Pakistan so was much of the reaction to these events.

There is no contesting the fact, that over the last six decades, the most dominant of all institutions in Pakistan, without doubt, has been Pakistan's army. It has ruled directly for thirty-three years, and has determined the direction of the state and most of its institutions—including political parties and general elections—for almost as long. It is not just Pakistan's military which has dominated Pakistan's political

and even economic spaces, using its might to privilege itself in a lopsided field determined through its hegemony, but over the last four decades, many of its clandestine organizations (primarily the ISI, but also Military Intelligence, or MI) have had a particularly strong influence in controlling the activities of political actors, as well as institutions and individuals who belong to civil society.

The military's overtly acclaimed misadventures include the 1965 war, Kargil in 1999, coups in 1958, 1977 and 1999, and their resulting consequences of causing the loss of East Pakistan following a brutal genocide by the Pakistani army of its own civilians. Islamization resulted in the worst kind of sectarianism in Pakistan and is the precursor to much of the militancy and fundamentalism in the name of religion in Pakistan today, and Pakistan's military general-presidents eagerly embracing frontline status in 1979 and 2001, bringing different wars home to Pakistan. There are other crimes as well, such as discarding and disregarding the Constitution, imprisonment, victimization and even the killing of political and civilian opponents, and such like. The covert adventures of Pakistan's ISI are too numerous to enlist and include alleged involvement in the Mumbai attacks of 2008 and the Mumbai riots of 1993, the attack on the Indian Parliament, and the alleged supporting of jihad. In addition, there is substantial evidence suggesting that the ISI has helped create terrorist organizations to use in Kashmir, Afghanistan and also in Pakistan.

However, this was probably the first time that Pakistan's military had been publically criticized for numerous shortcomings, which led to some of the events in May 2011. Of course the new non-state electronic media played a major role. Sadly, military generals, whether in 1958, 1977 or 1999, were welcomed by civilian politicians to take over the government, always supported by some political group or the other as well as, in Musharraf's case, by civil society and lifestyle liberals. Since military generals, and the military more generally, have been seen as saviours of the nation, there has been little criticism or opposition to their taking over power.[2]

Hence, the space which had been created (or won) by some sections of the non-military groups and institutions in Pakistan in finding their voice following the events described above, was a major departure from the past. *Perhaps for the first time, the hegemony of the military was questioned, even challenged,* with demands that (military) 'heads should roll' on account of the loss of Pakistan's 'sovereignty' and strategic security failures. If the military could not defend Pakistan's border/sovereignty, or its own military bases, then who would, was the question being asked, even in Parliament.

The front page of Pakistan's leading English daily, *Dawn*, on 8 June 2011, had the headline: 'PML-N [Nawaz Sharrif's party] in savage attack on generals'! According to the paper, in the National Assembly, 'the role of top generals, particularly vis-a-vis the so called war on terror, came under scrutiny'. Moreover, the 'lifestyle of top generals using expensive limousines', each worth 'eight crore rupees' and their 'inability to fight', is how a senior member of Parliament referred to the Pakistan Naval Chief of Staff coming to the PNS Mehran in a BMW soon after the attack. What is also significant here is not that the PML-N 'savagely' attacked the military generals in the budget debate in the National Assembly, but such a serious newspaper chose to use such words as its main headline on its front page. Television talk shows, of course, had a field day in attacking the military, again for the very first time since the media emerged as a prominent force around 2006 or so. The extensive revelations in *Dawn*, reproducing memos from Wikileaks, have shown how Pakistan's military had been complicit in the US drone attacks, while trying to show a nationalistic and patriotic public face.

Things That Changed

Before one makes the point that much has changed in Pakistan in recent years, perhaps sharply so since the middle of the last decade (probably since 2007), one needs to articulate, in extremely brief form, a sentiment and perspective of what existed previously—see Chapter 26 for a fuller explanation.[3]

Pakistan has not been a democracy for most of the 66 years that it has existed, with the exception of perhaps the Z A Bhutto era of 1971–7, although many scholars have called that a period of civilian authoritarianism or even dictatorship. There are many reasons why democracy has not existed in Pakistan, and range from explanations that the political leadership which created Pakistan, was composed of migrants from what became independent India, who had no political roots in Pakistan, to arguments which suggest that Pakistan was an over-developed state, with the bureaucracy and military being the most organized and powerful institutions which dominated Pakistan right from 1947 and 1948, increasing their control for numerous reasons.

In more recent years, the last two decade-long military regimes (1977–88, 1999–2008), have been supported by politicians who have even invited the military to take over in one case, and by civil society actors and 'liberals', in the second. Both the military generals Zia and Musharraf, made deep inroads into the non-military political and civic sectors, creating alliances with different groups of people. Accomplices were always willing partners to the military, and collaborators were always willing to have access to power. It has been the access to the centre of absolute political power, i.e. the military, which has allowed sections of Pakistan's civilian and political groups to support military dictatorships.[4] *A key explanation of why military rule has been so prolonged in Pakistan, is due to critical support from different sections of society, including justifications for military rule from the judiciary.*[5] While some actors and groups have given willing and voluntary support to military dictators to benefit from access to the seat of power, others have been bought over, bribed, cajoled, threatened and convinced through being made offers they could not refuse. The long and lucrative arms of the military ensured that opposition to military rule remains muted. A final and important explanation for why military rule persists in Pakistan, is because it has been given active diplomatic, military and financial support from the United States and its allies, both in 1979 following the Soviet invasion of Afghanistan, and in 2001, following the American-led invasion of Afghanistan.

Hence, through suppression, victimization, exile, as well as through accommodating different groups and actors, all backed by the powerful support of the United States, Pakistan's military dictators have ruled with ease for twenty years since 1971. However, some things began to change in 2007.[6]

To summarize some of the key developments since 2007, one can see the rise of a broad, politically active, civil society movement, led by lawyers asking for the reinstatement of the Chief Justice of Pakistan, who was summarily dismissed by President Musharraf in March 2007. In July 2007, a mosque and madrassah based in the heart of Islamabad, was attacked and 'cleared' of armed militants by Pakistan's law enforcing authorities resulting in many deaths estimated at anything between 100 to one thousand.[7] In addition, Musharraf imposed an 'emergency', not quite martial law, but suspending all basic and constitutional rights in November 2007. With the five years of Musharraf's parliament coming to an end in 2007, political activity also started and former exiled leaders, Benazir Bhutto and Nawaz Sharif were both given permission by the military to return to Pakistan to contest the elections. Musharraf had cut a deal with Benazir Bhutto where he would continue to serve as a civilian President while she would become the Prime Minister, the best form of collaboration and accommodation possible, far better than any attempts made in the past, ideally suited to both, as well as to the United States fighting its War on Terror.[8]

One of the most important developments in Pakistan in recent years, has been the electronic media explosion which has taken place since about 2005 or 2006. When the 2002 Musharraf elections were held, there was only one private TV channel. In 2008, when the next elections were held, there may have been around 60 or so, in regional languages, many of which were 24 hour news and information channels. The Lawyers' Movement of 2007 was shown live on every channel in Pakistan, where the 18–36 hour long-marches of the Chief Justice were watched by people of all sorts of ethnic and class backgrounds right across Pakistan. This was the first live television revolution of its kind in Pakistan, which had a huge and enthusiastic participatory audience. The military attack on the Lal Masjid in Islamabad mentioned above, was also shown live, as was extensive footage about Benazir's assassination in December 2007. This was a real media revolution which helped provide information, and explanation, of events that have taken place in Pakistan since 2007.[9]

Following Benazir Bhutto's assassination in December 2007, with Musharraf basically having lost any hope of staying on and with the military also tired and less popular after eight years of rule, elections in 2008 brought about a victory for the Pakistan People's Party with Yousuf Raza Gilani as Prime Minister and Asif Zardari eventually replacing Musharraf as President of Pakistan. The 2008 elections were believed to be fairer and freer than those held since 1970. There have been seven elections held between 1970 and 2008, but all have been manipulated and rigged. Pakistan moved from electoral politics in the 1990s to a praetorian democracy in 2002, to an evolving and emerging democracy after 2008. Despite instability and rumours galore about the collapsing presidency or the fall of the government, a transition to a democratic order seems to have been made.[10]

And Those That Didn't...

It has been the military's material might which has led to its domination over the state, which has given rise to the military reinventing itself as the sole guardian of Pakistan's many boundaries, frontiers and terrains. It has assumed the right to speak for the nation and its constituents and to even represent the nation. The justification for the national security state was created by Pakistan's military and the numerous civilians in positions of influence and power who have provided support to the military in one way or another. Whether using the threat from India, or more recently as the defenders of Pakistan in the War against Terror and against militancy, the military in Pakistan has used its power and position to create the narrative of the national security state, a state where the military defends the people, the frontiers and the interests of all Pakistan.

More recently, the military's bluff was called and it became clear that it was unable to determine whose interests it served, what those interests were and, hence, its inability to defend those interests. Moreover, this lack of clarity as to what exactly Pakistan's interest ought to be cost the military dear in terms of its reputation and image. It has, in fact, seen another layer being removed from the facade of what was justified as Pakistan's national security state. The falsity of the notion of the national security state was once again laid bare.

The military frequently appears unable to protect anyone's interests other than its own narrow ones, in terms of economic and material privileges. However, an important point which needs to be highlighted, is that the military's invention of itself as the saviour of Pakistan and as the defender of the land and the faith, is justifiable when one examines the interplay and positioning of different social forces.

Probably for the very first time, the military was being seen as the cause and creator of Pakistan's numerous problems, and not as the nation's saviour. This, despite the fact that western scholars and hacks, continue to write in their columns and books, that Pakistan's army/military 'is its only hope', and that it is 'an efficient and well-disciplined, united' institution.[11] And the US administration continued to side-step the freely and genuinely elected democratic civilian government in Pakistan (only the second one despite eight general elections) and talk to and cut deals with the military directly, strengthening the latter at the cost of democracy. The criticism and attacks on the military in the public media had been strong and certainly damaged the reputation of the military, challenging its hegemony over the state.

Why would the military not defend the interests of its large constituency and why should it not claim to speak as the nation itself? Institutions which are allowed to dominate will enforce that domination, and this should not come as a surprise. However, the problem in this relationship of power between the military and civilian and (for once) democratically elected institutions, is not so much the strength of the military but, more important, the cowardly, dithering and weak civilian elites and the compromises they have made with military power. The DG, ISI who spoke in

front of the National Assembly after the Abbotabad raid, volunteered to resign 'if asked'. He was never asked.

What might have looked like collapse in Pakistan in the summer of 2011, was the collapse of the dominance and hegemony of the military, but for a New Pakistan to emerge, politicians would still have been required to press for more space and enforce public sentiment. It was not often that one got this close to a chance to actually overthrow Pakistan's military.[12]

27.1.2. The Old and the New in *Naya* Pakistan: Elections 2013

The main slogan for the May 2013 Pakistan elections, was one of change, for a *naya* (new) *Pakistan*. The 2013 elections were as important and as critical as the 1988 elections which began the process of electoral politics—albeit not democracy—in Pakistan after a long, dark and cruel military dictatorship. This time round, in 2013, while the transition, the first ever from a democratically elected government to another, was very different compared to 1988, the importance of a break from the past, was perhaps more powerful and significant than that of the 1988 elections.

Breaking from the Past

There are numerous obvious examples of what was new in the elections and what were the many breaks from the past. For a start, perhaps the most important aspect of these elections was, that for the first time a democratically elected government held free and fair elections in Pakistan—albeit with allegations and proof of rigging in some polling stations. Moreover, the democratically elected government of 2008–13, willingly accepted its failures and congratulated the winning parties, and for the first time in Pakistan, a fully civilian government—no signs of Pakistan's model of praetorian democracy at play here—handed over power as per the Constitution to a caretaker government which passed on power to the elected governments in Pakistan. Given Pakistan's history of military intervention, control, meddling, oversight, and much else, all these firsts are by themselves, quite a remarkable achievement. While perhaps anticipated and somewhat expected in many ways given the apparent trends and signs since 2007 and again in 2011,[13] nevertheless, it is always still surprising in Pakistan's context that this process happened without the military's interference.

What is also new, is that, Nawaz Sharif was sworn in as Pakistan's first Prime Minister to be elected to that office for the third time, a record which is unlikely to be broken for many years to come. Equally refreshing, is the fact that the military general who removed Nawaz Sharif from office in October 1999 and became Pakistan's Chief Executive, and forced Nawaz Sharif into exile, at the time of writing [January 2014] after having spent time under house arrest, was being charged with treasonable offences. It is not often that a former president/general, and the former Chief of the Army Staff, is put under house arrest and investigation by Pakistani courts, ironically by many of the judges of the Supreme Court who sanctified General Musharraf's coup in October 1999. While there is speculation that Musharraf would be allowed to 'get away', even this temporary judicial and public humiliation, is an important first in Pakistan. Moreover, an extraordinary and unprecedented public debate took place on the so called security agencies, and by extension, on the covert role of the military, since the Abbottabad raid. While the military and its agencies have their supporters, there has been much criticism on the role and purpose of such entities. Public criticism of the military has never been so vocal in Pakistan.

All elected governments after Z. A. Bhutto—there have been seven—have been sworn in and functioned under Pakistan's military, often with a serving general as President of Pakistan or with help from the ISI. Nawaz Sharif seemed to be free of such fetters, again, a novel way to start the term of a democratically elected government in Pakistan.

Other equally new developments included the rise and fall of two parties, one new, the other old. For the first time since 1968, the Pakistan People's Party did not have a leader leading it into the elections, the tenth since 1970. Not only was there just no leader, there was no Bhutto to lead the party, clearly one of the two factors which led to the party, again for the very first time, receiving the third, rather than the second, highest number of votes.[14] Since 1970, the PPP has been either in government or in opposition as a formidable force, articulately led by a Bhutto. Not this time. Likewise, probably the newest of all new trends of the 2013 elections, again a new phenomenon not seen since 1985, when what was then called the Muhajir Qaumi Movement became a major political force in Karachi, has been the emergence of Imran Khan's Pakistan Tehrik Insaaf (PTI).

The fact that 56 per cent of the electorate voted, the highest proportion since 1970, must rest on the emergence of a second (or third) force on the political map of Pakistan. PTI received 18 per cent of the popular vote, converting into 24 National Assembly seats and the ability to form government in the highly important and sensitive Khyber Pakhtunkhwa province. This from a party which had only one Member of the National Assembly and only one Member of the Provincial Assembly in 2002, and none in the previous elections of 2008, as the PTI boycotted Musharraf's elections. By all accounts, much credit for bringing out the elite as well as this diverse category being called 'the youth' as voters, goes to Imran Khan's highly motivating and inspiring political campaign.

The PTI also deserves credit for becoming one of the few political parties to confront the major political force in Karachi, the Muttahida Qaumi Movement (MQM). Others had risen and failed, yet numerous members contesting the elections on the PTI ticket from Karachi were brave enough to challenge and confront the hold of a party variously described in the past as 'militant', 'authoritarian', 'fascist', and with such other epithets. It is certainly no small achievement to stand up to the MQM in Karachi, suggesting perhaps that the party may be losing its hold on the city. The fact that the PTI received as many as 30,000 votes from the heartland of the MQM in Karachi, signified a shift in the politics of Karachi, and also showed that even entrenched political parties could be challenged.

The End of Ideologies?

In the past, it has been possible to suggest some sort of ideological divide between political parties in Pakistan. The PPP was seen to be 'progressive' by many, Nawaz Sharif's Pakistan Muslim League (PML-N) socially conservative with an Islamic bent, the Awami National Party in Khyber Pakhtunkhwa as the nationalist Pakhtun party of Khan Abdul Ghaffar Khan and his heirs, and of course, the Islamists parties as just that. The 2013 elections have made such categories very fuzzy, and what is 'leftist', 'rightist', and especially 'conservative' in the course of political ideology, has become very blurred and far more complicated than one envisages.

Take the argument which did the rounds in Pakistan which suggested that a 'right wing wave' had swept Pakistan's recent general elections. The arithmetic based on the numbers of seats won and votes cast, would suggest that conservative parties won the election, and this in turn would also suggest, at least at first glance, that Pakistanis consciously shifted to, and chose, conservative and right wing candidates. Clearly, such an analysis simplifies electoral choices and does not fully explain Pakistan's apparent, and differentiated, turn to the right.

By all accounts, the numbers are persuasive and do support these conclusions. At the national level, Nawaz Sharif's Pakistan Muslim League Nawaz received 35 per cent of votes and Pakistan Tehreek Insaf 17.8 per cent. If we add some of the Islamist parties such as the Jamaat-e-Islami and Fazlur Rahman's Jamiat-e-Ulema Islam (JUI-F), and not counting the minor parties, then the total votes received by parties which are conservative—and there ought to be no two views about them being conservative—at least 57 per cent of the votes cast went to such parties, whether overtly Islamist or conservative of a different kind. If one wants to distinguish non-conservative parties, and include the PPP, ANP and MQM in this group—clearly a highly problematic proposition to call them 'liberal' and 'secular' given the nature of their politics—but just for the sake of the argument, then these three parties received merely 23 per cent of the popular vote.

Such analysis ignores many of the nuances which have had an effect on Pakistan's elections. One needs to examine the votes cast in light of broader factors. Take the case of the PML-N. It won resoundingly in the Punjab, not necessarily because there was a sudden lurch towards conservatism, but perhaps because the previous PML-N government in the province was seen by the voters as a party of choice worth investing in again. Re-electing a political party is not an ideological swing, but just reaffirms faith in that party. The PML-N was re-elected in the Punjab because the perception of the electorate of the Punjab was that the party had delivered whatever they felt was necessary. Of course, there was also a strong anti-PPP sentiment, for its failure to govern at the federal level, which added to the PML-N getting more votes overall. The PPP in the Punjab was also a leaderless party, which did not help its cause. The bastion of the PPP, southern Punjab, also collapsed on account of poor politics and poor governance.

In Khyber Pakhtunkhwa, where the PTI made extraordinary inroads, it is again difficult to sustain the argument that these were consciously political choices in favour of an Islamic conservatism. Having dismissed both of the last two elected governments in 2002 and 2008, the Pakhtunkhwa electorate has only shown its commitment to address problems of Islamic militancy in the province, by choosing the party it best feels able to do so. The fact that their choice is the conservative PTI, is a reflection of how the PTI has promised to deal with drones, the Taliban, and other militant factors. To suggest that this is also an ideological 'right wing' choice, is only partially correct.

A distinction needs to be made about the different types of conservatism in Pakistan and the electorates' choice of such politics. For instance, there is no doubt that Islamic political parties, such as the JUI-F and the JI, are conservative because of their understanding and politics based on religion. About the PML-N, one is probably not wrong in considering it similar to a European Christian Democratic Party, or one resembling Turkey's AKP, the Justice and Development Party, rather than related to the Muslim Brotherhood. The PTI, most of the time exudes the worst forms of conservatism and in many ways is an English-speaking Jamaat-e-Islami, but also talks about issues not very dissimilar to those of the PML-N. In terms of administrative reform and governance, it sounds more like the World Bank right wing technocratic crusaders, than Islamist ideologues.

The corporate, so called 'good governance', conservative agenda of both the PML-N and the PTI—which none of the so called liberal parties articulated—distinguishes them from Islamist political conservatism, and may have been a choice of the electorate in terms of service delivery, and is different from what is normally called conservative politics in Muslim majoritarian countries. Moreover, specific and local issues of politics may have also had a strong impact on how voters have voted.

The argument that Pakistan has moved to the right politically, or that the elections show a rise of politically and ideologically conscious conservatism, needs to be differentiated for its layered distinctiveness. Moreover, which party supports which ideology, also becomes a little problematic. For instance, the PTI in Khyber Pakhtunkhwa is imagined as a largely conservative political party, while it is seen as being 'progressive' and 'enlightened' by many who voted for it in Karachi. However, even if voters may not have made a conscious choice for conservatism, whether Islamic or of the 'good governance' variety, such choices bring numerous unintended consequences which have far reaching ramifications on society and politics, and perhaps the distinctiveness of ideological moorings will be better exposed as political praxis proceeds. Nevertheless, questions about which party supports which political ideology, remain largely unclear in the *naya* Pakistan.

Remnants of the Old

If anyone was tuned into Pakistan's growing and vibrant virtual social media, the verdict was clear: Imran Khan would sweep the elections and become Prime Minister. Not just social media, but the electronic media too, were caught up in the hype of the Pakistan Tehrik Insaaf, where

the potential election tally was raised each passing day as Imran Khan became perhaps the most vibrant and potent symbol of Pakistan's elections. Nevertheless, Imran Khan's tsunami turned out to be a virtual wave, rather than a real one. As some bloggers have confessed, social media is an echo which simply repeats itself and gives itself self-importance, believing only in itself. Anyone following different products of the virtual media would have indeed been led to believe that this new form of politics—dare one call what happens on social media 'political'?—trumped the old form of real and hard campaigning and contact with real people. However, in the 2013 elections, in the real world, it was the old, real, form, which scored over the new, the virtual.

Despite the resounding victory of Nawaz Sharif, the electoral map of Pakistan continued to shows a highly fragmented picture of regionalization. Although the PMLN could claim that it won seats in all four of Pakistan's provinces, its victory in Pakistan rested almost exclusively on its victory in the Punjab. Similarly, although the PTI won 24 seats, 16 of which were in Khyber Pakhtunkhwa. With the MQM and PPP in Sindh, the PMLN in the Punjab and PTI in Khyber Pakhtunkhwa, Pakistan's' politics reflects a deep fragmentation. Balochistan, as always, with the lowest turnout from any region, remained even further fragmented, with no single party anywhere near a majority, unlike the three provinces. With the lowest of the voter turn-out, in some constituencies politicians were elected with less than a thousand votes.

New expectations from the Old

Nawaz Sharif is not the fresh face of the elections, which supporters of PTI had hoped for, and has been in electoral politics since 1985. He is an old hand, if ever there was one, having been dismissed twice as Prime Minister of Pakistan, the last time when he even had a so called 'heavy mandate', with a two-thirds' majority in parliament. However, Pakistan has changed fundamentally since Nawaz Sharif was last Prime Minister in significant and, perhaps, permanent ways, some better and some which clearly reveal retrogression of the worst kinds. Despite being an 'old hand', indications so far, are that Nawaz Sharif has changed radically since his earlier days as Pakistan's Prime Minister.

The terms used in the media to describe Nawaz Sharif compared to fourteen years ago, included those which suggested that he has matured, learnt his lessons, become wiser, more accommodative, and other such positive terms to describe his new politics. Not just in 2013, but since 2007 when he returned to Pakistan after his exile, and especially as Pakistan's 'friendly opposition' during the last government's tenure, Nawaz Sharif did as much in protecting Pakistan's fragile democracy as did President Asif Ali Zardari. Both put their personal differences aside and were committed to strengthening democracy from all kinds of hostile forces, such as Islamic militants as well as Pakistan's military establishments and its many surrogates.[15] The past history of the PPP and Nawaz Sharif throughout the 1990s was one of confrontation, and looking to the military to oust the incumbent and replace it with the ever-ready opposition-in-waiting. Perhaps Pakistan's democrats have learnt some lessons.

When one thinks of the 'old' Pakistan, perhaps the one single institution which comes to mind, is the military. It has ruled Pakistan directly for thirty-three years, and has ruled indirectly for another eleven. In the years since 2008, its overbearing presence in the political life of Pakistan has been partially marginalized, at least for the moment. Nevertheless, despite the rise of new institutions, such as the media, judiciary and parliament, few would be hasty to dismiss the military as a powerful, perhaps even the most powerful, institution of Pakistan. Hence, Nawaz Sharif's pronouncements of how he is going to deal with the military, suggest a confidence not shown by any leader in the past except Z A Bhutto. This is probably not simply bravado and there were enough indications from Nawaz Sharif when he was elected in 2013, that he expected to be the civilian head of all institutions in the country. Whatever the eventual outcome, the old seemed to be looking like something new.

The same, and linked to it, has been his announcements, frank and outright, that Pakistan would befriend India, perhaps like never before. It is important to point out, a point missed by many, that India does not feature in the politics—and certainly in the electoral politics—of Pakistan. It did not in either the 2002 or 2008 elections, and given Pakistan's numerous and multifaceted problems, one didn't hear much of India in the 2013 elections either. If anything, the right-wing press castigated Nawaz Sharif for being soft on India. Again, much of the old changes.

Conclusions

To say that the 2013 elections were the most fascinating since 1988, is an understatement. Even though some parties which had been in power in the past were re-elected, one cannot deny that even the old showed numerous signs of a newness. Whether it was Nawaz Sharif, or even the MQM in Karachi embarrassed and in retreat, or the military, at least in retreat, or the PPP completely decimated, *electoral politics in Pakistan had a significant impact on challenging and perhaps even altering, old ideologies and outcomes*. The public discourse of politics in Pakistan has also undergone change, where the virtual sphere has formed false and comfortable ideologies and self-indulgent self-believers.

Whether such articulation, expectation and promise, would bring about a *naya Pakistan*, still needs to be seen. The more important question, however, knowing that not all newness is necessarily desirable—and clearly, there is much in the new which one would rather not have—is what exactly will be this *naya Pakistan*? With the clear absence of left-leaning and progressive alternatives similar to those which appeared after years of military dictatorship and after some initial years of conservative and right-wing democratic politics across Latin America, for many reasons, unfortunately, one fears that the best *naya Pakistan* might do, is look a little like Turkey, and not at all like Brazil.[16]

27.2 The Changing Character of the Pakistani State

This Section of the Chapter examines how the political economy of Pakistan has changed, both in theory and in reality with regard to actually existing Pakistan, and identifies problems and challenges in trying to theorize this new political economy. The Chapter is a critique of how political economy has been constructed in Pakistan, especially with regard to the state and the military—perhaps for understandable reasons usually seen as one and the same—ignoring actually existing Pakistan. Since Pakistan has changed in so many fundamental ways, one needs new ways of looking at the state, the military and its society.[17]

I begin with a very brief summary view of what has existed with regard to how the state and Pakistan's political economy have been theorized, and for this will do a very quick assessment of Pakistan's main theoretician of the state and its political economy, that of Hamza Alavi, and show how he envisioned the state. I then examine some critiques of Alavi suggesting new ways to build on his work, where relevant. I also examine some new formulations about how Pakistan is seen, such as Islam, 9/11, and some institutions. I will then identify some of the major changes that have taken place in Pakistan's social structure and its broad political economy and how the state functions. Following this, I turn to identify the restrictions/problems which exist in providing a systematic analysis of Pakistan's political economy. Unlike many countries in South Asia and elsewhere, it is difficult to look at trajectories of the Pakistani state in evolutionary terms or based on social structures and path dependence, or what Sudipta Kaviraj calls 'a combination of structural processes and conjunctural openings'. The question of the old debate about the autonomy of the state—relative or otherwise—with regard to social structure and class formation, poses an interesting challenge with regard to Pakistan. To what extent does Pakistan's social formation and social structure inform the behaviour and nature of its state?

27.2.1 Theorizing the Pakistani State

Despite a number of eminent scholars and academics and their work, there has only been one serious attempt of any significance to theorize Pakistan's state—but, importantly, not its society. Hamza Alavi's 1972 article and its subsequent reordering by him,[18] have defined, unfortunately for far too long, the limited debate on the state in Pakistan. His 'overdeveloped state' thesis laid the path which all scholars looking at the state in Pakistan, have earnestly followed. This is not the forum to examine whether even Alavi's overly-simplistic structuralist interpretation of the state in Pakistan was at all a faithful and careful explanation of the state in Pakistan *at that time*, for not only has much work already been built on the erroneous foundations, but any serious scholar in Pakistan today would certainly recognize a very different state and class structure in the country. One could even argue that Alavi's analysis is irrelevant to what Pakistan is today, since Pakistan is a very different country by every account, and his theorization today is merely of historical relevance.

The fact that all scholarship on the state in Pakistan owes allegiance to Alavi, speaks less about the intellectual insight and prowess of Hamza Alavi, but signifies, much more, the inability of Pakistani intellectuals, academics and scholars, to think for themselves.[19] In fact, Alavi's analysis laid the foundations of an unchanging, static, statist, mode and model of analysis, which still dominates discourse on social change and the nature and foundations of the state in Pakistan, in the fields of political economy, sociology and political science in Pakistan.[20] However, there are some notable exceptions who have opted to evolve different paths, looking more at social structure—i.e. actually-existing Pakistan—rather than what was considered to be the omnipresent, overbearing, dominant institution of the state with its core components. While there were and still are numerous flaws in Alavi's earlier analysis, perhaps the absence of an analysis—or even an understanding and recognition—of social forces, must stand out as his biggest failing. The fact that numerous scholars after 1972 did not recognize and correct for this failing, also accounts for the poverty of ideas amongst Pakistani scholars examining Pakistan's state and society. Only as it has become amply clear that Alavi's highly statist analysis does not help in explaining Pakistan today, has recent work emerged free of the shackles of the earlier rigidities.[21]

Here I very briefly summarize Hamza Alavi's key arguments about the nature of the state in Pakistan in 1972 through the most recent and thorough interpreter of Alavi's overdeveloped state thesis.[22] Aasim Sajjad Akhtar critiques Alavi's formulation and builds on it, highlighting significant weaknesses and adapts it to the present socio-economic and political formation of Pakistan. Following this summary and critique, I then provide some pointers which may help in designing and developing a further understanding of Pakistan's state, its classes and its institutions.

Simply put, Hamza Alavi's 1972 argument was based on the notion that a nexus of power existed in Pakistan between the landlords, the military, the bureaucracy and what he called 'metropolitan capital' which, based on Pakistan's colonial legacy and evolution, resulted in an 'overdeveloped' post-colonial state over an un- or underdeveloped society.[23] It was the military-bureaucratic 'oligarchy' with the three propertied classes of the landlords, industrialists and metropolitan or foreign capital, which kept what can be called Pakistan's political settlement in place, perhaps too functionally and rigidly. In fact, one of Akhtar's many critiques is to dismiss Alavi's 'static conception of structure that underlies his understanding of the overdeveloped state', and more than three decades later, using a Gramscian framework, Akhtar also brings in the political and cultural spheres of analysis which were missing in much of the neo-Marxist analysis of the 1970s.

As Akhtar reminds us, not only was an analysis and evaluation of society completely missing in most of Alavi's work, but so was that of resistance, and of the working classes. As Akhtar argues,

> [w]hile Alavi's model of this state has offered much insight into the legacy of colonialism and the state forms it left behind, arguably the most gaping hole in his theoretical treatise

> is the lack of attention paid to the politics of the subordinate classes, or in other words, the working people upon whose exploitation the entire system of power rests.[24]

There seems to be a complete absence of the *dynamics of change* and transition, in Alavi's work, and one wonders how a theory of superstructure could have been so easily formulated ignoring social and class dynamics.

Four decades after Alavi's formulation, it is not surprising that much has changed, not only with regard to how theorization takes place, but also in terms of social structures and classes in Pakistan. Akhtar recognizes these changes and introduces notions of the 'intermediate class'—loosely called the middle class by others—brings in religio-political movements and forces as players in the political arena in Pakistan, and presents the notion of the politics of 'common sense' of how people accept the norm of how power is articulated in Pakistan, hindering the possibility of popular politics and resistance and 'the existing configuration of power is reproduced as a function of both dominance and consent'.[25] Unlike Alavi's interpreting Pakistan's political settlement and nexus 'from above'—leading to a 'statist' approach of analysis which has left its deep mark on all social science of the state in Pakistan—by bringing in subordinate classes as well as groups and classes resisting the nature of the state, Akhtar adds much value to an analysis 'from below'.

This mode of analysis allows Akhtar to argue that 'the structure of power' has changed and is continuously evolving. The dialectic and the articulation between state, society, social classes, resistance and the like, was missing in Alavi's analysis. As Akhtar argues,

> The post-Bhutto conjuncture has been hegemonic insofar as the subordinate classes have participated in the designated political sphere *from below* as a matter of 'common sense'. In other words, working people directly contribute to the reproduction of power relations on the one hand by ascribing to the existing patronage-based rules of the game and on the other hand by choosing not to engage in a politics of opposition, confrontation, or what I have called here 'resistance'. This formulation is premised upon a dialectical logic whereby economic, cultural and political spheres are considered as a holistic unity, suggesting that there is an urgent need to understand politics and culture in greater complexity than has been done in Marxist analyses of Pakistan to date.[26]

And, '[u]ltimately however the emergence of a counter-hegemony that can reorder the prevailing configuration of power depends on the subordinate classes being able to regenerate a "politics of resistance" to displace the "politics of common sense"'.[27]

Another critical correction by Akhtar is critiquing Alavi's notion, where of the three 'propertied classes', he considered the metropolitan bourgeoisie to be the most powerful of the three. Akhtar makes the distinction between the capitalist logic of imperialism and its territorial logic, arguing that the nature of relationships between imperialism and Pakistan, need not be of the capitalist extraction kind, but one which fits in to a broader worldview of the territorial logic of imperialism, a fact which seems well articulated after 1979. Akhtar is correct in stating, that 'Alavi tends to analytically conflate the role of metropolitan *capital*, with the political impulse of metropolitan *states*, implying that the operational dynamics of these two qualitatively different manifestations of metropolitan power in the Pakistani social formation are indistinguishable.'[28]

Akhtar also argues that,

> the state oligarchy that existed at partition has changed considerably, as have the three propertied classes in Alavi's formulation. Crucially it has been the military's ability to lead the other members of the historical bloc, as well as new contenders for power that have emerged since the 1960s that explains the persistence of the Alavian nexus of power *from above*. Having said this the military's embeddedness within the patronage-based political system has in recent times given rise to increasing alienation because of its growing economic and political clout. The military's rapid rise to the pinnacle of economic, political and social power is in fact the greatest threat to oligarchic rule because it has endangered its historical relationships with other components of the historical bloc whilst also exploding the myth of its selflessness amongst the subordinate classes.[29]

While there is much to build on in Aasim Sajjad Akhtar's departure from Hamza Alavi, there is also some difference of emphasis and understanding. I cannot agree with Akhtar when he states that 'Alavi's basic contention that the post-colonial state is little more than a coercive apparatus and that this apparatus is directly inherited from the colonial state is compelling because the 'military-bureaucratic oligarchy' that was essentially a British creation *is still the country's dominant political force*',[30] and that 'Few scholars of Pakistan would disagree that the coercive role of the state and its ability to maintain a consensus with the dominant classes would appear to be the two defining features of Pakistan's political economy well into the 21st century'.[31] As I will show, it is perhaps not possible to see the state as such, given its fracturization and inability to function even at a 'normal' level.

Due to factors which Akhtar himself recognizes—the growth of the informalization of relations of production and exchange—it becomes difficult to acknowledge even the coercive nature of the state. By disagreeing with the understanding of Ali Cheema and Jonathan Addleton, who argue that the state has weakened, Akhtar argues that,

> state structure *has remained largely unchanged* in spite of the dramatic changes that have taken place throughout the social formation, primarily on account of the deepening of capitalism. On the other hand Cheema insists that the state has undergone considerable changes that have both

> conditioned and been conditioned by changes within society at large. In my understanding the state has changed considerably, thereby losing some of its power to direct the nature of change within the social formation. Yet the *Alavian nexus of power has remained intact by adapting the exercise of power* through state personnel and emergent social forces so as to facilitate both the accumulation of power and the accumulation of capital.[32]

And,

> this thesis argues that, though the empirics of capital accumulation in the unorganized sector as posited by Cheema, Hasan and Addleton are largely indisputable, the politics of the process has been such that the state has not been weakened, *but has in fact negotiated change in such a manner as to consolidate its power*. In other words, given that my concern is with the actual exercise of power, what Cheema and Addleton refer to as the fragmentation and weakening of the state has featured the institutionalization of a patronage-heavy politics that has insulated the oligarchy and dominant classes from counter-hegemonic challenges.[33]

Other disagreements exist over the role of the landed class. While at the micro level of articulation of power in rural areas, landed power may still be strong in many regions, although Akhtar does recognize that other intermediate classes in rural areas have also emerged to challenge the old landed power, it is difficult to concede to Akhtar's view:

> that despite the fact that the social power of the landed class has been eroded, it continues to exercise considerable political power primarily because of its continuing patronage by the state oligarchy, but also due to its long-standing politico-cultural entrenchment in the rural social formation. The state's continuing patronage of the landed class explains why the latter—and therefore the major political parties of the country—does not challenge the oligarchy and consents to remaining junior partner in the Alavian nexus of power.[34]

One is not convinced whether the landed class, especially in political parties, which Akhtar correctly recognizes are a new vehicle for patronage and access to the state, holds power beyond its immediate locational foothold. It is difficult to accept his argument where he states that, 'the mainstream political parties—excepting the religious parties—are still dominated by the landed class, and thus there is a feeling that if these parties were to represent any class interest unambiguously, it would be that of the rural notables,'[35] since this contradicts his other observation, that '[g]iven that the new bourgeoisie ostensibly can now represent itself through the political party, it is not totally reliant on the civil bureaucracy—or the military as the case may be—to gain access to the state'.[36] However, Akhtar does maintain throughout his thesis, that the urban commercial classes are now big players and that the landed class is now one patron amongst many.

There is little doubt that Aasim Sajjad Akhtar's reworking of Hamza Alavi's arguments of four decades ago, offers a corrective to the original formulation, critiques some key failings, and offers a remapping of key, new, developments. Perhaps most importantly, unlike Alavi, Akhtar brings in the *dominated classes* as a subject of analysis. While there has been able scholarship on the Pakistani industrial worker and on the peasant, there has been little analysis which examines the subordinate classes or the intermediate classes as a broader political category with the potential, according to Akhtar, to counter hegemony.[37] Based on Mushtaq Khan's development of the notion of 'political settlement', our understanding of the Pakistan state has been much enriched beyond the static analysis of Alavi. However, despite the value added to our understanding of the Pakistani state by Akhtar, some questions emerge in the current context of Pakistan's social formulation, which need further understanding and analysis. These are discussed below.

27.3 A State Without Power? The Fracturization of Power in Pakistan

This Section is an attempt to provide a sketch, or markers, which might lead to a theory of Pakistan's political economy, looking at institutions, structures and classes and builds on from the analysis in Chapter 26. It is tentative in every sense of the term, and is exploratory, examining possibilities for other scholars to reject, modify or develop. While there is no denying that there is a need for such a theorization, one must also acknowledge the difficulty in the task given the dearth of social science assessment in Pakistan. While many academics and scholars now talk about the 'clash of institutions' in Pakistan, or social classes, especially the middle class, and other such sociological phenomena, there has been only sporadic work, of any quality, which has examined social formations in Pakistan or the class structure and class interests, or analysed the nature of the Pakistani state beyond mundane and banal analyses.[38] Increasingly, 'class' has become a category which has lost relevance for the social sciences, and the discourse, especially in Pakistan, focuses on very broad categories, such as institutions, and on 'feudals', and the military.

Moreover, in recent years, understanding Pakistan has been premised on notions of 'Islam', and Pakistan is forced into an analytical Islamic framework, as if no other sense of existence or identity existed. While Islam is important in analysing Pakistan, it is certainly not the only dominant yardstick to examine Pakistan, especially its social formation and class categories. It seems that almost all books written on Pakistan, not just by westerners but also by Pakistanis, especially the Pakistani diaspora, privilege Islam over everything else when trying to understand Pakistan. Moreover, it is the Islam of

a post-9/11 era which has suddenly surfaced as the core of such analysis.[39] Due to this essentializing of Islam in Pakistan, numerous political events and actors are framed in this Islamic straightjacket. Hence, the 'Taliban' and the War on Terror, and markers of identity after 9/11, or the invasion of Afghanistan by US and NATO forces are all seen as part of an Islamic framework. Responses to the War on Terror are also seen as Islamic responses of jihad. While, clearly, Islam does play a role, this over-determining use of Islam as an explanatory category, undermines the role of geography, money, tribal loyalties, politics, classes, social formations and many other more mundane factors.

Work on ethnic politics has also ignored the role of class within ethnic categories, and there has been a clumping together of different ethnic groupings without regard to class, gender or any further differentiation. The question of imperialism and Pakistan's place in it, has also become blurred by the simplistic approaches of seeing the War on Terror as the only manifestation of imperialism, and opposition to drone attacks as 'anti-imperialistic', largely by the Pakistani diaspora, without seeing the social, economic and cultural manifestation of how imperialism is really articulated in any specific context.[40] The overlap with Pakistani religious parties cannot be ignored here, for whom anti-imperialism also simply means being 'against drones', or at best being anti-American, while continuing to eagerly take aid and monies provided by the US.[41]

I now highlight some issues and questions which require far greater analysis and interpretation in order to give some direction to thinking about Pakistan's political economy.

1. Who holds power in Pakistan? Which is the most dominant of the many groups, which wields power, over the state and its institutions, and over society?

Until around sometime in 2007, the question 'which is the strongest institution in Pakistan?', was always met immediately with the reply: 'the military'. The reply was unambiguous and did not call for any elaboration. For almost six decades after independence, Pakistan's military, specifically its army, reigned supreme over the political economy of Pakistan—see Chapter 26. However, since 2007, there is not just far greater ambiguity regarding the question, but for once, there are a number of possible answers. While the military is still powerful, it has now been forced to share the stage with at least two, and possibly three, institutions which can make some valid and genuine claim to be powerful. Perhaps not dominant, but at least vying for power, with varying degree, amongst a handful of contenders.

For the first time in sixty years, the certainty of who holds power in Pakistan can be questioned. The military's hegemony has been questioned, and at times even challenged, since 2007, by institutions which have not until now, been able to do so. The Judiciary, Parliament and to some degree the media, have tried to assert their independence and sovereignty over the public and political domain, in effect pushing the military aside, making elbow room at the table for themselves. In 2007, the Lawyers' Movement for the reinstatement of the Chief Justice of Pakistan, who was dismissed by the President General Musharraf, became one of the first movements of protest against the Chief of the Army Staff, and by some extension, of military rule and its hegemony. The Supreme Judiciary, and the reinstated Chief Justice of Pakistan, have since 2009, passed numerous judgments which have found the military as an institution, as well as serving and retired senior officers, guilty of treasonable offences. While many decisions and judgments are still pending and under review, and while some of those which have already been made have not resulted in the concerned officers being imprisoned, the fact that the Judiciary, which has until recently been a partner of the military in their anti-democratic political stance and decisions, is in a position to challenge the military and assert its own democratic and independent stance, is highly significant in a country which has not seen such belligerent action. As Najam Sethi, has argued:

> The reality is that the Pakistan Army exists as a state within the state in Pakistan. It is unaccountable to the civilians but it periodically holds them accountable via imprisonments and exiles during periods of martial law. Until recently, even the actions of a lowly serving military officer in relation to any civilian of any status could not be challenged in a civilian court. Indeed, court-martial decisions could not be overturned even in the Supreme Court of Pakistan. Defense secretaries have been nominated by the GHQ and routinely taken to spurning prime ministerial orders when these didn't suit GHQ. And army chiefs have stopped saluting elected prime ministers and presidents of the country.
>
> But this reality is changing with the establishment of a strong and questioning media, an aggressive parliament and an activist and independent supreme court. The many omissions and commissions, historical and current, of the generals are now being revealed and shed unfavourable light on their invincibility and credibility.
>
> Indeed, there is a rising consensus in civil society, media, government and opposition, that the military cannot lord it over them in the future. Under the circumstances, GHQ would be advised not to spurn public opinion just to save the face of three erring generals from its stock. Two decades ago, the "midnight jackals", as disgruntled officers in the ISI so called themselves, launched an operation to oust Benazir Bhutto from power. Today, the "day of the jackal" is fast drawing to a close.[42]

The Asghar Khan Case, as it is known, where a retired Air Marshal of the Pakistan Air Force, filed a petition against the involvement of the military and the ISI in the elections of 1990, has probably been the icing on the cake, signifying a militant and activist judiciary, and a vulnerable and retreating military. As the lawyer involved in the case has written,

> this was a case primarily about the army officers who had acted with scant regard for their role prescribed by the constitution. The prosecution and conviction of a bunch of politicians could be pursued once the liability of the generals had been determined... Despite the court's clear declaration that it did not propose to say anything about the armed forces or the ISI as institutions it was clear that the judgment in Asghar Khan's case would have profound implications, formal as well as informal, for the civil-military imbalance that has plagued the state throughout its history.[43]

While the consequences of this case and at least two others involving retired military generals, have been inconclusive as to how justice will prevail in terms of actionable outcomes, there has not been much precedence with courts headed by civilians having passed judgments against prominent military generals.

Equally refreshing, is the fact that the military general who removed Nawaz Sharif from office in October 1999 and became Pakistan's Chief Executive, was under house arrest on his return in May 2013 until November, with many cases, including one of treason, still under investigation. As Declan Walsh has argued, 'In a country where senior military officers are generally considered to be above the law, the sight of a former military ruler facing justice in a civilian court is a startling novelty'.[44]

Parliament has also flexed its independent muscles after 2008, to demonstrate its right to govern challenging the hegemony of the military. The media which has been a participant of this transition, has also been a tool for democratic forces to hound the military for its past anti-democratic behaviour and position. *The undisputed dominance of Pakistan's military in the Pakistani political settlement, has been successfully challenged*, and from being a hegemon, the military may at the moment perhaps just be a veto player.[45] And while there is no clear winner at this moment, for a country which has known military dominance for over six decades, these are extraordinary developments. The military is not what it once was in the eyes of the public nor in the equation which explains Pakistan's political economy.

I am not suggesting that that there is a power vacuum in Pakistan but, rather, that there are *competing contenders for power*, all located at different places in the class and state hierarchy. New actors—the media, the judiciary, parliament—have emerged and have claimed their power to influence the course of the state, its institutions and the direction and nature of political and economic decisions. Clearly, we are a long way away from the classical structuralist or even Marxist formulation of the Pakistani state being dominated by the landlords, industrialists and metropolitan bourgeoisie. Moreover, this re-examination of who holds power in Pakistan, leads to a number of critical theoretical questions based on actually-existing Pakistan.

2. Class, Interests, or Institution?

The analysis in Pakistan suggests that *institutions rather than class*, determine the nature of Pakistan's state. The media, judiciary and parliament, are all multi-class institutions, as is the military, although they all work for the defence of the capitalist order in which they function, for the defence of capital, with the purpose of accumulating it further. However, they are not class organizations in the way landlords or the industrial bourgeoisie are perceived to be. Yet, these are certainly not institutions which are radical, although they do occasionally raise their voice for the oppressed nationalities and peoples. Much of the analysis on Pakistan now deals with the role of institutions, its clashes with each other for hegemony, and so on.[46] Class seems lost in the analysis.[47]

The absence of class, of course, follows a global trend where class analysis has become less relevant generally, but also because in a country like Pakistan, institutions might not easily fit in to a class analysis. Nor, in fact, do classes themselves. The notion of intermediate classes, or the middle class, or working people rather than the working classes, complicates the ability to use class analysis effectively. In the absence of rigorous research, one would of course, argue that the ruling class, or ruling coalition in Pakistan, or ruling bloc, rules for the interests of capital, its protection and its reproduction, and for the preservation of the social order. On this there is little ambiguity. However, which classes or groups constitute that ruling coalition, is open to debate. Moreover, the fact that some social groups may be transient in any arrangement of the ruling coalition, dropping in and out of it as circumstances change, also makes analysis more difficult. Nevertheless, despite these challenges, there is a vague implicit understanding in the nature of the ruling coalition, although to what extent this is based on class or institution, is not very clear.[48]

3. The Informalization of Everything

It is not just the economy which constitutes a huge mass of the informal—or undocumented, underground, or black economy—but linked to the question of holding and articulating power, one could argue that the writ of the state does not run through or across Pakistan, and has been replaced by localised interests, vested groups, and mafias.

Estimates show that the informal economy of Pakistan was 91 per cent of the formal economy in 2007/08 which, according to researchers, is a considerable underestimate,[49] and given the boom in the unregistered/undocumented economy since then, suggests that this constituent of Pakistan's economy must have increased considerably. Evidence such as 70 per cent of Pakistan's population having mobile phones at a time when many economists think poverty is above 40 per cent of the population, also suggests a considerable informalization of the economy. With Pakistan, for the most part, almost all urban,[50] and even with rural areas now predominantly non-agricultural, with non-farm or non-agricultural sources of income dominating in rural areas, relations of production and exchange have undergone considerable transformation, different from what used to be considered the norm.

Not just the economy, but the state's main instrument, that which determines who actually wields power, the ability to do violence, has also been parcelled out and informalized and localized. The state's writ has been reduced geographically,

and private militias, goon squads, militants, groups which one can broadly call 'the Taliban', and such organizations, not only manifest their ability to do violence, but actually also challenge the brute force of the state. Power, or force, or violence, is not concentrated in the guise of the Pakistani state alone, and numerous groups exercise such power independent of the state itself.

Even in the case of essential services, such as social services, it is what is called the 'private sector', which provides protection, safety, electricity, water, education, health, etc. to the public, irrespective of where they are placed on the social and class hierarchy. The state continues to fail in fulfilling its social contract, and even basic aspects such as safety and protection, have been parcelled out to private firms. This so called 'private sector', is barely regulated or monitored, and is a law unto itself, usually oblivious to, or regardless of, the law which ought to regulate such non-state activity. Along with the large informal economy, one has informal institutions, all unregulated, undocumented, unchecked.[51] These are elements of a weak, fractured, state, not a strong one.[52]

4. Geography and Geo-Politics

Pakistan's state and its society have been shaped markedly by events which have originated outside its geographical borders, notably in Afghanistan. Whether it has been fighting Soviet expansionism or US designs, wars in Afghanistan have had major repercussions on the state and society in Pakistan. It is not possible to undertake an analysis of either without bringing foreign interests right in the centre of the equation. Whether it is the role of Saudi Arabia or the United States, their influence around and in Pakistan, may have altered the trajectory of society and of the state, perhaps permanently.

While the rise of Islam and its influence has been most marked in Pakistan since at least the mid-1970s, global and regional events have given Islamization in Pakistan a very different form altogether, well before 9/11. This interaction of money, arms and influence from abroad, has resulted in some of the issues raised above, such as the informalization of the state, of the economy through remittances, of the ability to carry out violence with jiahdists following an unspecified sectarian agenda, and the rise of new organizations and institutions which have developed parallel to the state, such as religious institutions. Perhaps the territorial logic of the United States may have been the strongest force amongst the many which assert considerable influence and power over Pakistan, and the extent of US influence also highlights the comprador and co-opted nature of the institutions of Pakistan's state, especially the military and government. A complicit and comprador civil and military elite is unable to develop national and nationalist agendas, whether they be economic, political or diplomatic. It is probably local fractures and weaknesses which allow for too much space to be appropriated by foreign powers.[53]

5. Counter-Hegemony?

And what of social groups and classes who oppose the system of exploitation and expropriation? The absence of an organized left political movement since the mid-1970s, and the recent rise of globalized and globalizing middle classes and groups, has meant that the margins look more like the mainstream. Opposition to the state is led more by sections of what we can call the middle classes—such as those demanding water and electricity, not connections, but uninterrupted supply—rather than the working classes, labour and peasants, demanding better working conditions or higher pay. It is the unorganized nature of protest which distinguishes Pakistan from the past, from the 1960s and 1970s. The decline in trade unions and in class politics, broadly defined, has made protest far more middle class, and in many ways giving rise to an *apolitical politics*.[54]

The one form of counter-hegemony which stands out in Pakistan, is that of militant Islam, which varies its politics and target depending on specific circumstances. Organized and unorganized Islamic jihadist groups have challenged and continue to challenge, the state of Pakistan, and its institutions such as the military and parliament and politicians perceived to be not-Islamic-enough. It is also the spontaneous street support of such groups—not all of them are jihadists and many reflect the so called softer versions of Islam—which also underscores the point made above, of the privatization and informalization of the ability to do violence, as well as the state's reluctance and inability to directly confront such forces.

If there is any counter-hegemony in Pakistan, it is of the Islamic militant kind, ignited more by moral injury, not one based on class, of the subaltern classes or the working people although, a vast proportion of Islamic militants, particularly those that take to the streets, represent what are also subaltern classes and working peoples. The contrast with two such events in September 2011 underscores the marked difference in the politics of the street and of the suppressed classes. There were huge protests all across Pakistan, many of them very violent in which public and private property was destroyed and two dozen people were killed, in reaction to a blasphemous film on YouTube. Thousands of Isalmists, not all of them militants or jihadis, took to the streets on 19 and 20 September 2011, even in small towns across Pakistan in rage, to protest against the film. In sharp contrast, when 259 workers, both men and women, were burnt to death in a garment factory in Karachi on 11 September 2011, a week earlier, there was barely any reaction, by any political party or segment of civil society, or even by the workers and trade union movement, against the owners of the factory or the Labour Department responsible for overseeing the safety and security of workers. The nature of the Islamists' protest and politics does not have class issues as motivators and are not limited only to local or domestic issues, and their protests are frequently triggered by global and international responses of a religious kind. Such apparently non-material and abstract triggers, do of course, have very real and material consequences, although make analysis even more problematic.[55]

6. Those 'Unknown Unknowns'

Any objective study of analysis ought to be based on current understanding and knowledge in order to answer many questions, even about the nature of Pakistan's state. Yet, time and time again, social scientists in Pakistan have not been able to identify likely scenarios, or give a convincing explanation of what has happened even after the event. Predictions in Pakistan are notoriously impossible, and predicting Pakistan's future equally difficult, given the fact that events around Pakistan have such a strong bearing within the country. The Soviet invasion of Afghanistan in 1979, 9/11, and other less dramatic events, all unpredictable, had an impact on Pakistan which has lasted decades, and has taken a course completely unanticipated prior to them. Unlike many other countries which have their logic of path dependence, internal consistency, and allow one to make projections into the future, one must emphasize that Pakistan does pose a severe challenge to do the same, to say the least.[56]

27.4 Conclusions

When the Chief Justice of the Supreme Court of Pakistan has to take *suo moto* notice of a killing of a taxi driver in Karachi by the Rangers, a para-legal institution, one wonders if there is such a thing as a functioning 'state' in Pakistan which goes about its normal business in a supposedly normal manner. Either that, or whatever the norm for the state in Pakistan is, it seems to be different from the norm of a functioning state in many developing countries. Moreover, this particular *suo moto* notice is one of many, where the Chief Justice has had to intervene in the way government sets prices, deals with vested interests, and undertakes its daily business. Where is the state in the way Pakistan functions? Even if one concedes that theoretically, the monopoly of violence rests with the state, in the context of Pakistan, that monopoly has been fractured and appropriated by numerous militias and mafias right across Pakistan, with non-state actors probably being more powerful than state actors in many regions of Pakistan—and one is not here talking about the Federally Administered Tribal Areas, but even Karachi. The state does not even any longer have monopoly over violence in Pakistan, nor does it have the ability to tax or to protect its people (including the elite).

The over determined dependence in analyzing Pakistan's state, over its society or social formation, has resulted in much of the scholarship on Pakistan's political economy and political science, being largely 'statist' and straight-jacketed. This has resulted in scholarship undermining and ignoring the changing nature of Pakistan's social formation resulting in the continuously changing nature of Pakistan's state. Not just static, but this statist analysis, owing much to the path dependence created by Hamza Alavi's over-determined state analysis of 1972, has followed a top-down approach, inconsequential of actually-lived conditions and relationships. Pakistan may not have an overdeveloped state, but it certainly does have overdeveloped statist analysis.

While there has been some change over the last couple of decades, much of the discourse on Pakistan's state and its social formation, is still very Alavian and statist. In some cases, this statism has more recently, been replaced by an Islamic lens, where all developments in Pakistan are realized and explained, not just through an Islamist perspective, but a perspective deeply embedded in 9/11. Often scholars fail to distinguish between actually-existing Islam in Pakistan, and the War on Terror and the changing geometry after 9/11. Islam and '9/11' are used interchangeably, obfuscating any serious analysis.

Hamza Alavi's analysis of the Pakistani state, was constructed at a time of top-down military dictatorship and limited temporal value. Perhaps the reason why his research lacked an analysis of social relations of production and of the social structure, was because the nature of the state under military dictatorship may have been *considerably more autonomous* and it may not have been important to explain how the state responded to social structures and developments. Under civilian and democratic government, it becomes far more difficult to ignore social structures.

As has happened so many times in Pakistan's history, events with unintended consequences have shaped Pakistan's developments. Yet, social and economic change has also been somewhat anticipated and predictable, giving rise to somewhat more certain outcomes. The immense growth of urbanization, that of a middle class, a hugely buoyant informal sector, and the breakdown of state authority and of state institutions, have been unfolding almost expectantly. The previous trend of the 'urbanization of everybody', seems to have morphed into an 'urbanization with informalization', with the co-movements of urbanization and informal relations of production and exchange perhaps dominating social and political interaction. What this means for subsequent developments remains uncertain and one can merely (hesitantly) speculate about alternative scenarios.

What this short exploration has tried to do, is to examine the numerous, and often contradictory, issues and problems which emerge in trying to look at a statist or Islamist Pakistan. Both undermine the vast array of processes which are at work and feed into the nature of Pakistan's state and society. Scholarship in and on Pakistan's political economy, still lacks a comprehensive theory of the Pakistani state, and of its society. My attempt to identify and explain the issues and constraints in doing so, does not resolve the problem in how to construct a new political economy of Pakistan, but I hope it will point in the right direction in which one can begin the conversation about ways in doing so.[57]

Notes

1. A commission, known as the Abbottabad Commission was set up to investigate the raid and events surrounding it. The Report was leaked in July 2013 confirming the fact that Pakistan's military establishment, while perhaps not complicit in the circumstances, bore a great deal of responsibility for many of the events. The Report was seen as a further indictment of Pakistan's military in the public sphere in Pakistan.
2. See some of the articles in Zaidi, S. Akbar, *Military, Civil Society and Democratization in Pakistan* (Lahore: Vanguard, 2011).
3. This section, and some of the ideas in this Chapter draw on a previous article written in *Economic and Political Weekly*, 'State, Military and Social Transition: The Improbable Future of Democracy in Pakistan', vol. 40, no. 49, 2005, much of which is reproduced as Chapter 26. In the article I had argued for the improbability of democracy taking root in Pakistan for numerous reasons. However, events since 2007 have proven me wrong. One certainly gets a sense of a growing of democratization in Pakistan and that there are an increasing number of groups and interests in protecting and promoting forms of democracy. What we don't know, however, is whether this is a permanent change or a brief moment of contradiction to the norm.
4. See some of the articles in Zaidi, S. Akbar, *Military, Civil Society and Democratization in Pakistan* (Lahore: Vanguard, 2011).
5. See, Kalhan, Anil, '"Gray Zone" Constitutionalism and the Dilemma of Judicial Independence in Pakistan', *Vanderbilt Journal of Transnational Law*, vol. 46, no. 1, January 2013, on how the judiciary has been equally complicit in helping the military in bringing about military governments in Pakistan.
6. These themes have been discussed in greater detail in Ibid.
7. Many of the subsequent suicide attacks in Pakistan are said to have been in response to this action by the State.
8. Benazir Bhutto had said: 'It would be an honour for me to take up that role [of Prime Minister] and General Musharraf would be there as President'. See S. Akbar Zaidi, *Military, Civil Society and Democratization in Pakistan* (Lahore: Vanguard, 2011), 185.
9. This is not to state that the media is necessarily a positive vehicle of change, bringing in democracy and liberty, for the media in Pakistan has played a dangerously reactionary role as well. Some have argued that the media trapped the Salman Taseer, the Governor of the Punjab into saying things that he did not mean, which resulted in his being killed.
10. One must add that Pakistan's democracy is a newly emerging democracy and comparisons with India, or even Bangladesh, are misleading. It is still in the stages of developing and only more years of civilian assertion will ensure that Pakistan actually becomes a democracy. Without doubt, work in progress, and there is still more to be done.
11. Much of the recent literature by western academics looking at Pakistan in the age of terror has made this argument. For an extensive critique, see Zaidi, S. Akbar, 'Contesting Notions of Pakistan', *Economic and Political Weekly*, vol. 47, no. 45, 2012
12. The discussion which appears as Section 27.1.1 was written and published in June 2011. See Zaidi, S. Akbar, 'Is Pakistan Collapsing?', *Economic and Political Weekly*, vol. 46, no. 25, 2011.
13. See Zaidi, S. Akbar, 'Is Pakistan Collapsing?', *Economic and Political Weekly*, vol. 46, no. 25, 2011.
14. Benazir Bhutto had been assassinated prior to the 2008 elections, but she led the party into those elections and the party received a fair share of sympathy votes on account of her assassination.
15. S. Akbar Zaidi, 'Resilience in Pakistan's Democracy? The Tahirul Qadri Episode', *Economic and Political Weekly*, vol. 48, no. 5, 2013.
16. This Section is a shortened version of Zaidi, S. Akbar, 'The Old and the New in *Naya* Pakistan', *Economic and Political Weekly*, vol. 48, no. 25, 2013.
17. An earlier version of this part of this Chapter was presented at the South Asia Institute seminar series at Columbia University and I am grateful for comments made by Akeel Bilgrami, Partha Chatterjee, Valentine Daniel and Mahmood Mamdani. Comments from Afiya S. Zia and Faisal Siddiqi are also appreciated. This, and subsequent parts of this Chapter, were published as 'Rethinking Pakistan's Political Economy: Class, State, Power and Transition', in *Economic and Political Weekly*, vol. 49, no. 5, 2014.
18. See for example: Alavi, Hamza, 'The State in Post-Colonial Societies: Pakistan and Bangladesh', *New Left Review* 74: 59–81, 1972; Alavi, Hamza, 'Class and State in Pakistan, in Hasan Gardezi and Jamil Rashid (eds.) *Pakistan: The Unstable State* (Lahore: Vanguard, 1983); and, Alavi, Hamza, 'Authoritarianism and Legitimation of State Power in Pakistan', in S. K. Mitra (ed.) *The post-colonial State in Asia: Dialectics of Politics and Culture* (New York: Harvester Wheatsheaf, 1990).
19. See Zaidi, S. Akbar, 'The Dismal State of the Social Sciences in Pakistan', *Economic and Political Weekly*, vol. 37, no. 35, 2002.
20. Two notable exceptions which have examined the nature of the state in Pakistan differently, are: Sayeed, Asad U., 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995, and Cheema, Ali, 'Rent-seeking, Institutional Change and Industrial Performance: The Effect of State Regulation on the Productivity Growth Performance of Pakistan's Spinning Sector 1981–1994', unpublished PhD dissertation, University of Cambridge, 1997. Both Sayeed's and Cheema's work was based on the highly insightful and original work of Mushtaq H. Khan, who critically examined the work of Hamza Alavi. See: Khan, Mushtaq H., *The Political Economy of Industrial Policy in Pakistan 1947–1971*, SOAS Department of Economics Working Paper No. 98 (London: SOAS, University of London, 1999).
21. Probably the most outstanding and impressive representation of this sociological frame is Qadeer, Mohammad Abdul, *Pakistan: Social and Cultural Transformations in a Muslim Nation* (New York and London: Routledge, 2006).
22. Akhtar, Aasim Sajjad Akhtar, *The Overdeveloping State: The Politics of Common Sense in Pakistan, 1971–2007*, unpublished PhD Dissertation, University of London, 2008.
23. It is interesting how Sudipta Kaviraj reaches similar conclusions with regard to his 'over-extended' state in India under Nehru's democracy and the bureaucracy, while Alavi builds his analysis on Ayub Khan's military dictatorship

and the bureaucracy. See Kaviraj, Sudipta, 'A State of Contradictions; The Post-colonial State in India', in Quentin Skinner and Bo Stråth (eds.), *States and Citizens: History, Theory, Prospects* (Cambridge: University of Cambridge, 2003).
24. Akhtar, op. cit., 193
25. Ibid. 32.
26. Ibid. 15.
27. Ibid. 16.
28. Ibid. 116. However, Akhtar adds in a footnote, that 'In his empirical analysis, Alavi's focus is on the manner in which the geo-strategic interests of imperialist states, and particularly the US, have been a major cause of the militarization of the Pakistani state'.
29. Ibid. 42.
30. Ibid., 8, emphasis added.
31. Ibid.
32. Ibid., 76, emphasis added.
33. Ibid., 161, emphasis added.
34. Ibid. 79.
35. Ibid. 112–13.
36. Ibid. 111.
37. Akhtar seems to have an optimistic, or at least hopeful, possibility of the subordinate classes being better represented in organized political parties. See Akhtar, Aasim Sajjad, '21st Century Socialism in Pakistan?', *Economic and Political Weekly*, vol. 47, no. 45, 2012.
38. For a selection of some of the better work, see, amongst others: Ahmad, Aijaz, 'Class, Nation, and State: Intermediate Classes in Peripheral Societies.', in Johnson, Dale, (ed.) *Middle Classes in Dependent Countries* (New Jersey: Rutgers University Press, 1985); Ahmad, Aijaz, 'Democracy and Dictatorship in Pakistan' in *Lineages of the Present: Ideological and Political Genealogies of Contemporary South Asia* (London: Verso Books, 2000); Ahmad, Saghir, *Class and Power in a Punjabi Village* (New York: Monthly Review Press, 1977); Alavi, Hamza, 'The State in Post-Colonial Societies: Pakistan and Bangladesh', *New Left Review* 74, 1972, 59–81; Alavi, Hamza, 'Class and State in Pakistan, in Gardezi, Hasan and Jamil Rashid (eds.) *Pakistan: The Unstable State* (Lahore: Vanguard Books, 1983); Alavi, Hamza, 'Authoritarianism and Legitimation of State Power in Pakistan.' in S. K. Mitra (ed.) *The Post-colonial State-in Asia: Dialectics ofPpolitics and Culture* (New York; Harvester Wheatsheaf, 1990); Cheema, Ali, 'State and Capital in Pakistan: The Changing Politics of Accumulation,' in Ananya Mukherjee-Reed, (ed.) *Corporate Capitalism in Contemporary South Asia: Conventional Wisdoms and South Asian Realities* (Basingstoke: Macmillan-Palgrave, 2003); Hashmi, Bilal, 'Dragon Seed: Military in the State,' in Gardezi, Hasan and Jamil Rashid (eds.) *Pakistan: The Unstable State* (Lahore: Vanguard Books, 1983); Jalal, Ayesha, *The State of Martial Rule: The Origins of Pakistan's Political Economy of Defence* (Cambridge: Cambridge University Press, 1990); Khan, Mahmood Hasan, *Underdevelopment and Agrarian Structure in Pakistan* (Boulder, Colorado: Westview Press, 1981); Khan, Mahmood Hasan, *Lectures on Agrarian Transformation in Pakistan* (Islamabad: PIDE, 1985); and, Sayeed, Asad U., 'Political Alignments, the State and Industrial Policy in Pakistan: A Comparison of Performance in the 1960s and 1980s', unpublished PhD dissertation, University of Cambridge, 1995. For the most recent and ambitious attempt to re-articulate the nature of the state in Pakistan, see the excellent thesis: Akhtar, Aasim Sajjad Akhtar, *The Overdeveloping State: The Politics of Common Sense in Pakistan, 1971–2007*, unpublished PhD dissertation, University of London, 2008.
39. The list of such books is too long to recount here, but some popular books which have emerged recently and speak for Pakistan with Islam (and the military) forming the main analytical and explanatory tool include: Cohen, Stephen P. and Others, *The Future of Pakistan* (New Delhi: Oxford University Press, 2011); Lieven, Anatol, *Pakistan: A Hard Country* London: Allen Lane, 2011); and Lodhi, Maleeha (ed.), *Pakistan: Beyond the 'Crisis State'* (Karachi: Oxford University Press, 2011). For one of many critiques, see Zaidi, S. Akbar, 'Contesting Notions of Pakistan', *Economic and Political Weekly*, vol. 47 no. 45, 2012.
40. Such knee-jerk and simplistic reactions and accusations by Pakistani scholars living in the West, in London and New York, are not uncommon. For example, see Iqtidar, Humeira, 'Secularism and Secularisation: Untying the Knots', *Economic and Political Weekly*, vol. 47 no. 35, 2012, and Toor, Saadia, 'Imperialist Feminism Redux', *Dialect Anthropol*, Volume 36, Issue 3–4, December 2012, http://link.springer.com/article/10.1007/s10624-012-9279-5/fulltext.html
41. In Khyber Pakhtunkhwa, for example, the previous government of the Muttahida Majlis-e-Amal (MMA), and now Imran Khan's party, the Pakistan Tehrik-e-Insaf (PTI), have followed this hypocritical political practice.
42. Sethi, Najam, 'Pakistani Army can no Longer Lord over Rest of the Country', *India Today*, New Delhi, 14 September 2012, http://indiatoday.intoday.in/story/pakistani-army-can-no-longer-lord-over-rest-of-the-country/1/217257.html
43. Raja, Salman Akram, 'Asghar Khan's Vigil', *Dawn*, Karachi, 31 October 2012.
44. Walsh, Declan, 'Bail for Pakistani Ex-leader Paves Way for His Exit', *The New York Times*, 9 October 2013.
45. Marcus Mietzner shows how the Indonesian military after three decades lost its hegemonic position to become not even a veto player. See, Mietzner, Marcus, 'Veto Player No More? The Declining Influence of the Military in Post-authoritarian Indonesia', in Mirjam Kunkler and Alfred Stepan (eds.), *Democracy and Islam in Indonesia* (New York: Columbia University Press, 2013).
46. Waseem, Mohammad, 'Clash of Institutions in Pakistan', *Economic and Political Weekly*, vol. 47, no. 28, 2012.
47. I am not comfortable using 'institutions' as a medium of analysis as a substitute for the 'old fashioned' question of class, and realize the limitations of doing so. Institutions are continuously dynamic entities, both internally in how they are constituted, and the way they interact with other institutions or the state. Rather than use institutions to explain class and state dynamics and interaction, it might be useful to talk of 'competing narratives' or institutions as 'discursive practices'. These alternatives also have familiar problems. While there has been some excellent scholarship on the Pakistani military, understandably, there has been far too little research on institutions which have more recently acquired some public legitimacy. Also see Endnote 38.
48. Akhtar raises the question of whether the military is a class, and using a synthesis of Marxist and Weberian notions, argues that, 'by virtue of its dominance in the political, economic and wider social realm, the military stands defined as a dominant class', Akhtar, Aasim Sajjad, op. cit., 235.

49. Kemal, M. Ali, and Ahmed Waqar Qasim, 'Precise Estimates of the Informal Economy', Paper presented at the 28th Conference of the Pakistan Society of Development Economists, Islamabad, November 2012.
50. Reza Ali's seminal unpublished work shows that perhaps 98 per cent of the Punjab lives within two hours of a city, 82 per cent about one hour away. His assessments based on the Census of 1998, fifteen years ago when so much has changed, suggests that approximately 74 per cent of the Punjab was urban (in 1998), Sindh 53 per cent, Khyber Pakhtunkhwa 45 per cent, and Balochistan, mainly Quetta, 12 per cent.
51. Arif Hasan documents the rise of such organisations and institutions, although does not examine the politics of the emergence of them. See his Hasan, Arif, *The Unplanned Revolution: Observations on the Process of Socio-economic Change in Pakistan*, Oxford University Press, Karachi, 2009.
52. While there are obvious similarities with what Partha Chatterjee calls 'political society' in urban India and much of Pakistan, because of the nature of the weak state in Pakistan, unlike say India, the relationship with state and society, and hence with politics, is bound to be different. See Chatterjee, Partha, *Lineages of Political Society: Studies in Postcolonial Democracy* (Ranikhet, India: Permanent Black, 2011). Mahmood Mamdani has pointed out the apparent contradiction in this informalization of Pakistan on the one hand, with the arguments made above which highlight the presence and consolidation of institutions, on the other, giving rise to further complexities and unresolved questions in thinking about Pakistan's political economy.
53. Mahmood Mamdani suggests that Pakistan is 'similar to many states, even African ones', and that my argument for giving Pakistan any sense of uniqueness, is flawed. While there are certainly many similarities between Pakistan and many other countries, I still maintain that while not unique, there are some peculiarities or coincidences which assert a marked sense of difference even between countries which might seem to be similar. Moreover, a country with almost 200 million inhabitants might not be quite comparable with countries which are much smaller.
54. Aasim Sajjad Akhtar has a far more optimistic assessment of Pakistan's left. See his '21st Century Socialism in Pakistan?', *Economic and Political Weekly*, vol. 47, no. 5, 2012.
55. I should add that such forms of demonstrations are neither new nor unique to Pakistan. Many such events have led to similar demonstrations in the past in Pakistan, and were widely held across the Muslim world. Yet, their nature and frequency has changed in Pakistan, becoming far more violent and more frequent, for which explanations are limited and inadequate. The politics of affect and of moral injury remains under-explored in Pakistan.
56. This is a bigger problem than we imagine. In 1977 and in 1999, whatever analysis social scientists undertook to explain the social basis of Pakistan's military coup and the subsequent regimes, this was made redundant by the unanticipated and unpredictable events which took place in Afghanistan in 1979 and 2001.
57. After the publication of the article in *Economic and Political Weekly*—see Note 17, above—a series of articles were published by the journal in response to my original article. See the five responses and my rejoinder in 'Political Economy of Pakistan', *Economic and Political Weekly*, vol. 49, nos. 26 and 27, 2014.

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ISSUES IN PAKISTAN'S ECONOMY

A POLITICAL ECONOMY PERSPECTIVE

THIRD EDITION

S. Akbar Zaidi

This book is about understanding Pakistan's structural transformation over six decades in a political economy framework. The author examines how and where such transformations have taken place in the economy, society, in class and gender relations, in manifestations of consumerism and culture, and in other ways. He assesses Pakistan's trajectory of economic and political development and focuses on an economic and social history of Pakistan, using a political economy framework to examine the nature of this structural transformation. The book follows the narrative of the evolution of Pakistan's social, economic and even political dispensation over many decades, highlighting key developments and events. As has happened so many times in Pakistan's history, events with unintended consequences have shaped developments. Yet, social and economic change has also been somewhat anticipated and predictable, giving rise to relatively more certain outcomes. The immense growth of urban populations, of a middle class, and of a buoyant informal sector, alongside the breakdown of state authority and state institutions, has been unfolding almost expectantly. The previous trend of the 'urbanization of everybody', seems to have morphed into an 'urbanization with informalization', with the co-movements of urbanization and informal relations of production and exchange perhaps dominating social and political interaction. What this means for subsequent developments remains uncertain.

Issues in Pakistan's Economy: A Political Economy Perspective will interest serious scholars of Pakistan's economic history and its developments, as well as those who seek to understand how social and economic processes have an impact on numerous outcomes and forms of structural transformation, and how state and society evolve in a political economy perspective.

S. Akbar Zaidi is a prolific political economist. Apart from his interest in political economy, he also has great interest in development, the social sciences more generally, and increasingly, in History. He has written over seventy-five academic articles in international journals and as chapters in books, as well as numerous books and monographs. His recent book, *Military, Civil Society, and Democratization in Pakistan* (2012), examines the political economy of the Musharraf regime. His earlier books include *The New Development Paradigm: Papers on Institutions, NGOs, Gender, and Local Government* (OUP, 1999), and *Pakistan's Economic and Social Development: The Domestic, Regional, and Global, Context* (2004). He taught at Karachi University and at Johns Hopkins University, and is currently a Visiting Professor at Columbia University, New York, where he has a joint appointment at the School of International and Public Affairs (SIPA), and at the Department of Middle Eastern, South Asian, and African Studies (MESAAS).

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